



A REPORT
TO THE
MONTANA
LEGISLATURE

PERFORMANCE AUDIT

Tax Increment Financing Administration and Impact

Department of Revenue

FEBRUARY 2018

LEGISLATIVE AUDIT
DIVISION

17P-03

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Performance audits conducted by the Legislative Audit Division are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Members of the performance audit staff hold degrees in disciplines appropriate to the audit process.

Performance audits are conducted at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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February 2018

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of Tax Increment Financing Administration and Impact administered by the Department of Revenue.

This report provides the legislature information about the use, oversight, and impacts of tax increment financing. This report includes recommendations for enhancing oversight and statutory clarification. A written response from the department is included at the end of the report.

We wish to express our appreciation to officials and staff at the department and local governments for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

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MONTANA LEGISLATIVE AUDIT DIVISION

PERFORMANCE AUDIT

Tax Increment Financing Administration and Impact

Department of Revenue

FEBRUARY 2018

17P-03

REPORT SUMMARY

Tax increment financing (TIF) is used by local governments for urban renewal and economic development purposes. While TIF districts are established at the local level, the Department of Revenue is responsible for administering TIF on a statewide basis. We determined the TIF approval process is unreliable, the certification of TIF district values is not always accurate, property tax revenues can be incorrectly distributed, and a lack of accurate data results in stakeholders not being informed of TIF activities. In addition, unclear statutes have contributed to uncertain TIF administration expectations. Although TIF can lead to increased taxable property value, this effect is not uniform and this financing mechanism may not be appropriate for all Montana communities.

Context

Since 1974, local governments in Montana have been able to create different types of economic development districts to fund projects using a statutory financing provision called tax increment financing, commonly referred to as tax increment financing (TIF) districts. The statutory goals for these districts are to combat blight or improve infrastructure in order to attract or retain value-adding industry. State law provides local governments flexibility in achieving their development goals using TIF. Prior to creating a TIF district, local governments must adopt an urban renewal or comprehensive development plan that identifies blighted conditions and infrastructure deficiencies within the district. This plan establishes goals, objectives, and strategies on how these conditions will be addressed.

When a TIF district is established, the original property value of the district is calculated and set as the “base value” to continue to be taxed normally by local taxing jurisdictions. Ideally, as development projects are completed in the district, property value will rise above the base value. This additional property value, which is called the “increment value,” is taxed at the same rate as the base value, but the generated

revenue (“tax increment”) is segregated to fund development projects in the TIF district. In cases where TIF revenue is not sufficient to pay for more costly improvements, debt, such as bonds, can be issued against future TIF revenue to fund projects. For example, a major local sewer and water system project may need long term financing to complete. Anticipated tax increment revenues can be used to secure a bond issued for up to 25 years. As of 2016, there were 55 active TIF districts in 24 local governments, which segregated approximately \$35.7 million dollars in tax revenue to the districts in tax year 2016.

Though TIF is primarily implemented at the local level, state government also plays a role in administering TIF districts. In particular, the Department of Revenue (DOR) is responsible for calculating the value of properties in these districts to determine how much taxable property value is available to the TIF districts. DOR also approves districts prior to providing property values and reports basic TIF information in its biennial report. Apart from valuation of property within these districts, DOR has historically had minimal processes in place for administering TIF activities.

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Results

We found local TIF districts use different management practices, debt financing, and project types to meet local development goals identified in their urban renewal or comprehensive development plans. Additionally, we found DOR has not developed TIF-related policies or processes to ensure its duties are consistently or accurately completed. Consequently, the TIF approval process is unreliable, the certification of district values are not always accurate, there are instances of district revenues being incorrectly distributed, district information is not being accurately maintained, and stakeholders are not informed of state expectations. Lastly, we assessed the impacts of TIF and found while it does effect the taxable value of property, the extent of the effect is dependent on complicated demographic features of the community using the provision.

Audit recommendations to DOR include:

- ◆ Updating TIF administrative rules to include necessary documentation to confirm districts are created according to statutory requirements.
- ◆ Creating a process to verify certified base and increment values for TIF districts and establishing formal lines of communication for local governments to address issues with values.
- ◆ Providing county treasurers with an alternative method for calculating the correct distribution of tax revenue in TIF districts.
- ◆ Establishing and implementing a process to coordinate the collection, entry, and maintenance of TIF district information.
- ◆ Developing a process to communicate TIF policy and statutory requirements to stakeholders.

Additionally, the audit recommends the legislature:

- ◆ Clarify TIF laws, including district qualifications, statutory goals, state and local administration, monitoring, and how tax increment financing is evaluated.

Recommendation Concurrence	
Concur	3
Partially Concur	3
Do Not Concur	0
Source: Agency audit response included in final report.	

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Chapter I – Introduction

Introduction

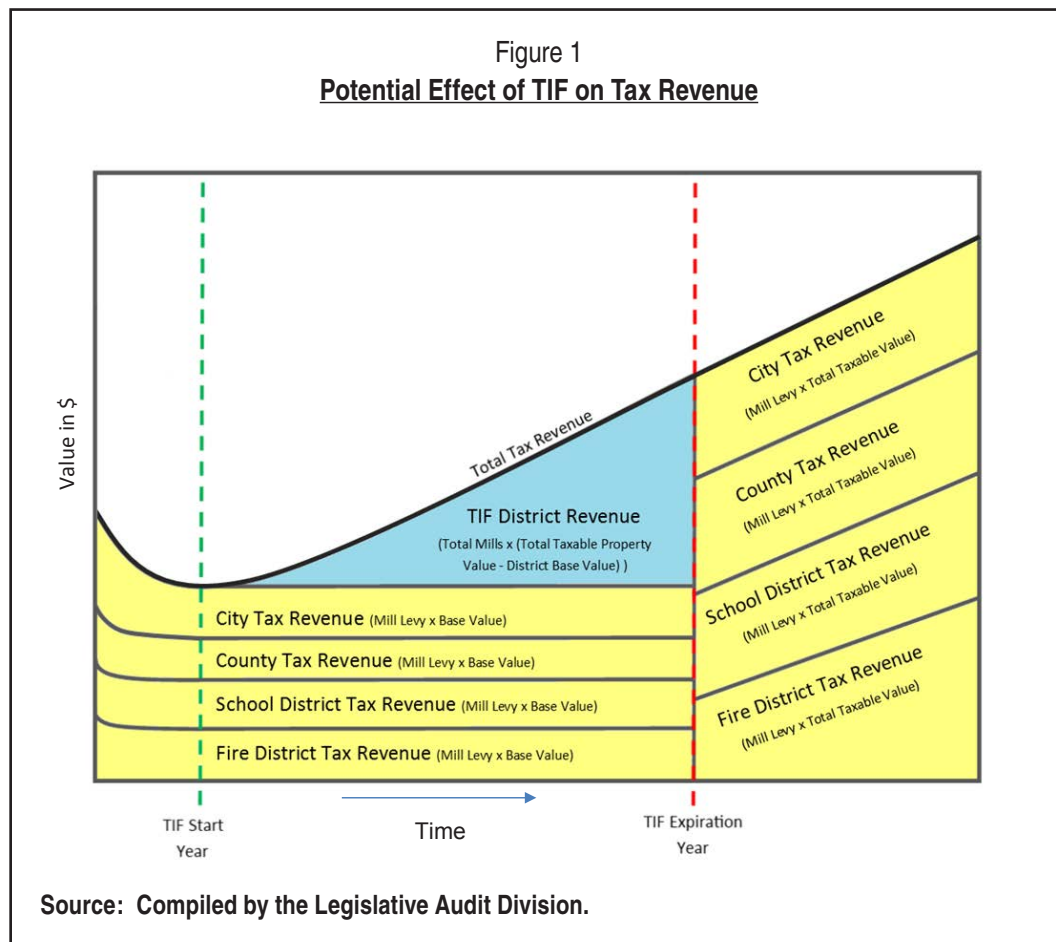
Tax increment financing (TIF) is a financing provision used by local governments in 49 states and the District of Columbia to fund local development efforts. This provision segregates tax revenue generated from new property value growth for a period of time and within a specified boundary (development district) to be used for area development projects. The theory behind TIF is development projects completed in an area will generate property value growth above what would otherwise occur. By reinvesting tax proceeds from this property value growth back into the district, it is anticipated to one day release higher total property value back to local taxing jurisdictions for taxation purposes.

In Montana, a development district is a contiguous area chosen by the local government to fund projects that either combat blight or improve infrastructure for value-adding industry. As of 2016, there were 55 development districts using TIF in 18 counties across Montana. State law authorizes local governments to establish development districts and use TIF, but state involvement is required in the implementation due to the state's property tax system structure. While local taxing jurisdictions calculate, bill, and collect property tax revenue, the Department of Revenue (DOR) is responsible for property valuation and general supervision over tax administration. Based on legislative interest, the Legislative Audit Committee identified a performance audit of this financing provision as a priority. This chapter discusses the purpose of tax increment financing and describes the roles of state and local governments in TIF administration and related property tax assessment and collections. This chapter also discusses the scope, objectives, and methodologies of our audit.

Function of Tax Increment Financing

A local government can intervene in an area, typically with stagnant or declining property values, by capping the amount of property value taxing jurisdictions can use to generate tax revenue. A taxing jurisdiction is a government, such as a state, city, county, or school district, that levies taxes within a certain geographic region. This cap is referred to as the “base value” of the district and is determined by calculating the taxable value of property in the year prior to the TIF district's creation, referred to as the “base year.” Ideally, as the area is improved and property values increase, the taxable value of the district will increase above the base value. This increase in taxable value above the base value is referred to as the “increment value.” The increment is taxed at the same rate as the base value of the district, but the tax revenue from the increment (“tax increment”), with some exceptions, is segregated to be reinvested into the TIF district for a period up to 40 years. This revenue can be used for a number

of development purposes, such as conducting feasibility studies, removing blighted structures, or building and repairing public infrastructure. If the taxable value of the district never increases above the base value, all available taxable value beneath the base value will be taxed by the usual taxing jurisdictions. As a result, the TIF district does not receive any revenue to complete TIF funded projects for that tax year. Once TIF has been used in the district for its maximum lifespan, or the local government terminates the TIF district, the new total taxable value of the area is once again available for taxing jurisdictions to use to generate tax revenue. Figure 1 illustrates how the implementation of a TIF provision alters the way tax revenue is distributed in a TIF district.



As shown, TIF districts are often created when property tax values are declining in an area. Once the TIF district is established, the intent is to increase the tax increment in order to invest it back into the district until it sunsets. This should increase the property value in the area over time in excess of what the property value would have been without TIF. In the meantime, the taxing jurisdictions in that area are restricted to taxing a maximum of the property value that existed when the district was first created. There are a few exceptions to this; voter-approved mills added after a TIF

district is created and the 6-mill university levy, or a tax rate of \$6 of tax per \$1,000 of taxable property value sent to the Montana University System, are still directed for use by the taxing jurisdictions levying the mills. For the rest of the taxing jurisdictions, any tax revenue collected from gains in total taxable property value above the base value are sent to the TIF district until the district expires. Once the district expires, the other taxing jurisdictions can once again use the entire taxable value of the area for taxation purposes. Ideally, this area's new total taxable value should be higher than what would have occurred naturally without establishing the TIF district.

TIF districts are sometimes used in conjunction with, or instead of, other types of special districts. For example, Business Improvement Districts and Special Improvement Districts are areas in which taxpayers approve, by ballot measure, a levy of additional taxes to pay for specific improvements. A Business Improvement District may involve an additional mill levy in order to improve a commercial business area, and a Special Improvement District might be created to levy for reasons such as lighting, street maintenance, or parking. The primary difference between TIF districts and these other districts is TIF does not levy additional mills.

Tax Increment Financing in Montana

In Montana, TIF is a financing provision that can be used to fund projects in certain types of locally-created development districts. Legal authority for the use of TIF can be found in the Urban Renewal Law, in Title 7, Chapter 15, Part 42 and 43, of the Montana Code Annotated. Table 1 (see page 4) lists some of the different components of this law.

Table 1
Components of the Urban Renewal Law

Types of Development Districts	Characteristics	Statutory Reference
Urban Renewal Districts (URD)	Redevelop or rehabilitate blighted areas in cities and towns.	§7-15-4203, MCA
	Municipalities must complete certain requirements including documenting the existence of blight and approving an urban renewal plan.	§7-15-4209, MCA - §7-15-4217, MCA
	Municipalities can use URDs to plan urban renewal projects for the elimination and prevention of blight through redevelopment, rehabilitation, and conservation in an area in accordance with an urban renewal plan.	§7-15-4202, MCA
Targeted Economic Development Districts (TEDD)	Develop infrastructure to encourage the location and retention of value-adding industry in cities, towns, or counties.	§7-15-4278, MCA
	Prior to creating the TEDD, the area must be found deficient in infrastructure improvements and have a comprehensive development plan adopted.	§7-15-4279, MCA
Industrial, Aeronautical, and Technology Districts	Repealed in 2013, these districts had similar requirements to TEDDs, with additional restrictions on the type of development to be either industrial, aeronautical, or technology in nature.	§7-15-4268, MCA - §7-15-4276, MCA
Financing Methods	Characteristics	Statutory Reference
Tax Increment Financing (TIF)	A provision that allows the tax from property value growth to be used to fund projects in development districts.	§7-15-4282, MCA §7-15-4283, MCA
	Requires the sponsoring local government to submit documentation of the TIF provision to the Department of Revenue and each affected taxing body.	§7-15-4284, MCA
	Can be used to pay costs, such as, but not limited to: <ul style="list-style-type: none"> ♦ Land acquisition ♦ Demolition of structures ♦ Construction or improvement of public infrastructure or publicly owned buildings 	§7-15-4233, MCA §7-15-4288, MCA
Other	Local governments can also use their general fund, intergovernmental loans, development agreements, state and federal grants, bonds, and other methods to finance projects in development districts.	§7-15-4218, MCA §7-15-4252, MCA §7-15-4258, MCA §7-15-4267, MCA §7-15-4281, MCA §7-15-4289, MCA §7-15-4290, MCA

Source: Compiled by the Legislative Audit Division.

The Urban Renewal Law describes the types of development districts local governments can create, which currently includes urban renewal districts (URDs) and targeted economic development districts (TEDDs). The primary purpose of URDs is to encourage redevelopment and combat blight. Blight is defined in §7-15-4206, MCA, as issues such as physical dilapidation, defective construction, and unsanitary or unsafe conditions in communities. TEDDs are intended to develop public infrastructure in infrastructure-deficient areas and encourage the development of value-adding industries in towns, cities, and counties. Prior to 2013, TEDDs were split into three different types of more specialized, but less flexible, development districts called industrial districts, aeronautical districts, and technology districts. No aeronautical districts were ever created, but some technology and industrial districts were grandfathered in and are still active today. In all of these development districts, the local government works through a public process to establish a plan to encourage the desired growth in the area. This plan may include projects the local area would like to complete in the district and the financing mechanisms needed to complete them.

Section 7-15-4283, MCA, classifies TIF as a financing provision for use in development districts. However, when development districts such as URDs and TEDDs adopt a tax increment financing provision, they are commonly referred to as TIF districts. For the purposes of this report, URDs and TEDDs (or other development districts) that use tax increment financing will be referred to as TIF districts.

Role of State Government in Property Tax and Tax Increment Financing

Though local governments are allowed to create and manage TIF districts under the Urban Renewal Law, the state, through DOR, plays an important role in their administration. DOR is responsible for assessing property value across the state for taxation purposes. Property tax is a major source of revenue for local governments, school districts, and other localized taxing jurisdictions. According to the U.S. Census Bureau, 96.9 percent of local government tax revenue was from property tax in 2015. The state also collects property tax revenue for school equalization purposes, making up 9.4 percent of all state taxes collected in Montana in 2015.

Several DOR offices and divisions play a role in property assessment and TIF administration:

- ♦ **Property Assessment Division (PAD)** is headquartered in Helena and is comprised of offices located in four geographic regions responsible for assessing property values. Property assessment activities are conducted by staff located in county field offices within each region. When TIF districts are created, PAD determines the base and increment values of the district and ensures the correct parcels are included in the district's values and that

they are labeled properly in DOR's property tax database. This database, called Orion, contains records of ownership and valuation information for all property subject to taxation in the state. The county PAD offices annually calculate and report the official total taxable value of all property (certified property values) within the county boundaries to each taxing jurisdiction, including TIF base and increment values, in certified value forms.

- ♦ **Business and Income Tax Division (BIT)**, in addition to other duties, oversees the appraisal and assessment of industrial and centrally assessed property belonging to businesses. Centrally assessed and industrial property appraisers determine and record values so PAD can generate the certified value forms. Regarding TIF districts, BIT is responsible for identifying the centrally assessed and industrial property in a district's base and increment values. Industrial property in a TIF district is self-reported by property owners to BIT.
- ♦ **Tax Policy and Research**, located in the Director's Office, conducts analysis of tax and economic data and compiles DOR reports for department administration, the legislature, and the public. This includes reporting basic statewide TIF district information in its biennial report.
- ♦ **Legal Services** is another component of the Director's Office. In regard to property tax, it helps write rules; interprets statutes, rules, and policies; and resolves disputes. Additionally, it approves and denies the creation of TIF districts.

Though DOR conducts all property assessment in the state, other agencies do play auxiliary roles in the administration of TIF. The Office of Public Instruction, in addition to their general responsibility for overseeing school financing, also ensures school districts properly report and use payments from TIF districts. The Department of Administration's Local Government Services Bureau helps local governments abide by financial reporting requirements, provides guidance to local government auditors, collects and reviews annual reports and audits from local governments, and follows up with audit recommendations. Beginning next year, it will also review whether or not local governments with TIF districts report their expenditures as required by changes to §§2-7-503 and 7-15-4282, MCA, passed in the 2017 regular Legislative Session. The bureau will also begin to provide more detailed guidance to local government auditors on the legal requirements of TIF for use in their audits.

Role of Local Government in Property

Tax and Tax Increment Financing

Local governments play a role in property tax and TIF. Once local taxing jurisdictions receive DOR-calculated property values, they determine what tax rate, also known as a mill, they need to levy to collect enough revenue to meet budgetary needs.

The county treasurer is in charge of issuing tax bills, collecting tax money from taxpayers, and distributing taxes to local jurisdictions. To issue the tax bills, the treasurer uses a software program to generate bills and track payments. This software program receives individual property information from DOR's Orion database. In some counties the local PAD office imports these values into the treasurers' tax billing system to make sure everything balances, while in other counties the treasurer is responsible for ensuring their system is correctly updated. Throughout the tax year, the treasurer will distribute the taxes to appropriate jurisdictions, including the special fund for the TIF district.

A local government's elected governing body is responsible for creating a TIF district, establishing its budget, and approving or denying projects or expenditures within the district. They also establish the management structure for the TIF district, including hiring managers and selecting board members.

Audit Scope

Through audit assessment work, we determined TIF is implemented across multiple divisions within DOR, as well as numerous county and municipal governments throughout the state. We identified three risk areas related to TIF requiring further review: local government implementation, state administration, and the overall impacts of TIF. Due to a lack of state-level information on TIF use, characteristics of districts were gathered from local staff and district documentation. Of particular interest were the reasons for establishing TIF districts and methods used to manage these districts. Regarding state oversight, we focused on the state's TIF district-approval and data compilation processes, along with the mechanics of calculating, collecting, and distributing the tax increment of these districts. Finally, the impacts of TIF for the state were analyzed in relation to the extent of its effect on property condition, employment, property value, and other local benefits.

Audit Objectives

We developed the following three audit objectives:

1. Determine how Tax Increment Financing is being used to combat blight and infrastructure deficiencies across the state as required by state laws and rules.
2. Evaluate the Department of Revenue's oversight role of Tax Increment Financing in regards to district approval, certification, and monitoring to ensure districts are operating according to state laws and rules and department policies.
3. Determine the impacts of Tax Increment Financing Districts in Montana, including property value and condition, employment, and other state and local benefits.

Audit Methodologies

To accomplish our objectives, the following work was conducted:

- ◆ Reviewed applicable state laws, administrative rules, and department policies to determine the state's expectations for TIF administration and performance.
- ◆ Reviewed TIF statute, rules, and evaluations in other states to learn alternative methods of administering of TIF.
- ◆ Reviewed academic research and industry best practices regarding TIF oversight and administration.
- ◆ Evaluated 28 local government TIF provision application packets submitted between 2010 and 2016 to determine if DOR consistently and accurately approves TIF applications.
- ◆ Interviewed DOR staff in Helena and regional offices to determine state TIF administration processes and experiences.
- ◆ Interviewed local government staff, TIF managers, and county treasurers for 34 TIF districts in eight counties.
- ◆ Collected and reviewed TIF district documentation including bonds, development agreements, expenditure summaries, and district plans to learn of the different ways TIF is being used at the local level and compared findings to state goals and requirements.
- ◆ Surveyed 33 regional and county DOR staff (with a response rate of 78 percent) who work with TIF districts to determine their roles and experiences in administering TIF.
- ◆ Surveyed all TIF district managers and local government financial officers in counties and municipalities using TIF (61 total individuals) to identify potential areas of risk, learn of perceived impacts, and verify the accuracy of records from DOR. The overall response rate was 62 percent, but 98 percent of TIF districts were represented by a manager response.
- ◆ Confirmed expiration dates in DOR records by reviewing bond offering statements for districts extended past their 15-year lifespan.
- ◆ Reviewed the Department of Administration's Local Government Services Bureau local government auditor compliance supplement to assess whether they guide local government auditors in considering TIF in their audits.
- ◆ Collected interlocal agreements that provided remittances from TIF districts to school districts and compared these to the Office of Public Instruction's data of school districts receiving remittances from 2011 to 2016 to confirm all remittances were properly reported.
- ◆ Interviewed stakeholders to learn of challenges of administering TIF and measuring their impacts. Stakeholders interviewed included a municipal bond counsel firm and an underwriting firm, the League of Cities and Towns, the Montana Association of Counties, the Montana Taxpayers Association, and an independent consultant that works with communities to establish and administer TIF districts.

- ♦ Reviewed available documentation including project plans, summary of projects, ordinances, expenditure reports, board meeting minutes, development agreements, studies of blight or infrastructure deficiency, and district lawsuit documentation to evaluate impacts and challenges of TIF experienced across the state.
- ♦ Used DOR property data, census data, and spatial data to analyze the effect of TIF on property value growth.

Overall Summary and Report Contents

We determined TIF is used in many different ways by local governments to combat blight and address infrastructure deficiencies. A variety of different management structures and methods are used to meet local development goals. We also determined DOR will need to improve statewide administration of TIF, including the processes associated with creating districts, certifying property values, distributing tax revenue, compiling district information, and communicating expectations of TIF administration to local governments. Lastly, statute should be clarified in a number of areas related to TIF administration and evaluation. The role of the state in TIF administration is not well defined, nor are there any performance goals specific to TIF. As a result, TIF evaluation is limited at the state level and mostly based on anecdotal evidence. Our analysis indicates that TIF can, but does not always, positively affect taxable value of property in TIF districts relative to other property.

The remainder of this report contains information regarding our audit findings, conclusions, and recommendations.

- ♦ Chapter II details local governments use of TIF across the state and discusses general characteristics of TIF, including:
 - ◇ Reasons for creating TIF districts,
 - ◇ Different district management structures, and
 - ◇ Other details related to how TIF is currently being used.
- ♦ Chapter III discusses DOR's TIF oversight including approval, certification, and data compilation of TIF districts.
- ♦ Chapter IV addresses the need for statutory clarification in TIF laws and describes the impacts of TIF districts, including our statistical analysis on TIF effects on property value growth.

Chapter II – Local Government Use of Tax Increment Financing in Montana

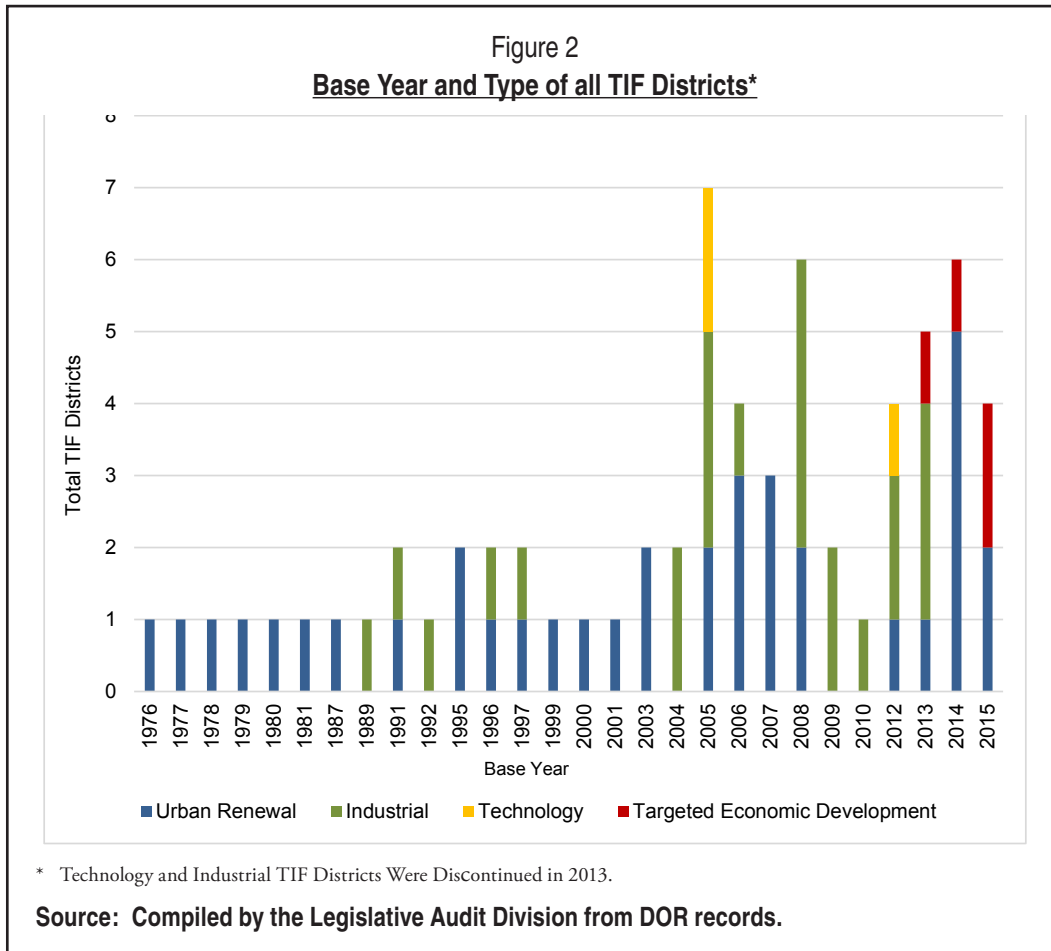
Introduction

This chapter addresses our first objective to evaluate how tax increment financing (TIF) is used to combat blight and infrastructure deficiencies. We determined there is limited state level information about how TIF is being used by local governments for urban renewal or infrastructure development to attract and retain value added industry. In addition, legislators have requested additional information regarding how TIF is being used at the local level. Therefore, we conducted work within local governments to obtain information regarding TIF district use. Our work included site visits to three counties, seven municipalities, and one consolidated city-county government. We also conducted interviews with the managers of 32 TIF districts, reviewed TIF district documents, and conducted a statewide survey of district managers and local government financial officers. In particular, work for this objective considered:

- ♦ The types of TIF districts being used,
- ♦ Why districts were created,
- ♦ The management and decision-making structure of the districts,
- ♦ District debt financing,
- ♦ Historic use of remittances,
- ♦ The public process used to communicate district activity, and
- ♦ The types of projects completed within the districts.

Historic Use of Tax Increment Financing

The first TIF statutes were enacted in 1974 as part of the Urban Renewal Law in order to finance local government efforts to combat blight. Since 1974, at least 74 TIF districts have been initiated by local governments, not all of which were successfully set up. The first was created in 1976 and sunset in 2008. Figure 2 (see page 12) shows the number of TIF districts created with base years between 1974 and 2015. Typically, the base year of the TIF district is the tax year prior to the creation of the district, so this figure includes all districts created through 2016.



As illustrated by the figure, the creation of TIF districts remained low and fairly steady for the first few decades of the provision's existence before experiencing periodic spikes starting in 2005. There is not a clear explanation for the recent increase in the creation of TIF districts, except that there was an overall increase in targeted economic development districts (TEDDs), technology districts, and industrial districts after 2004.

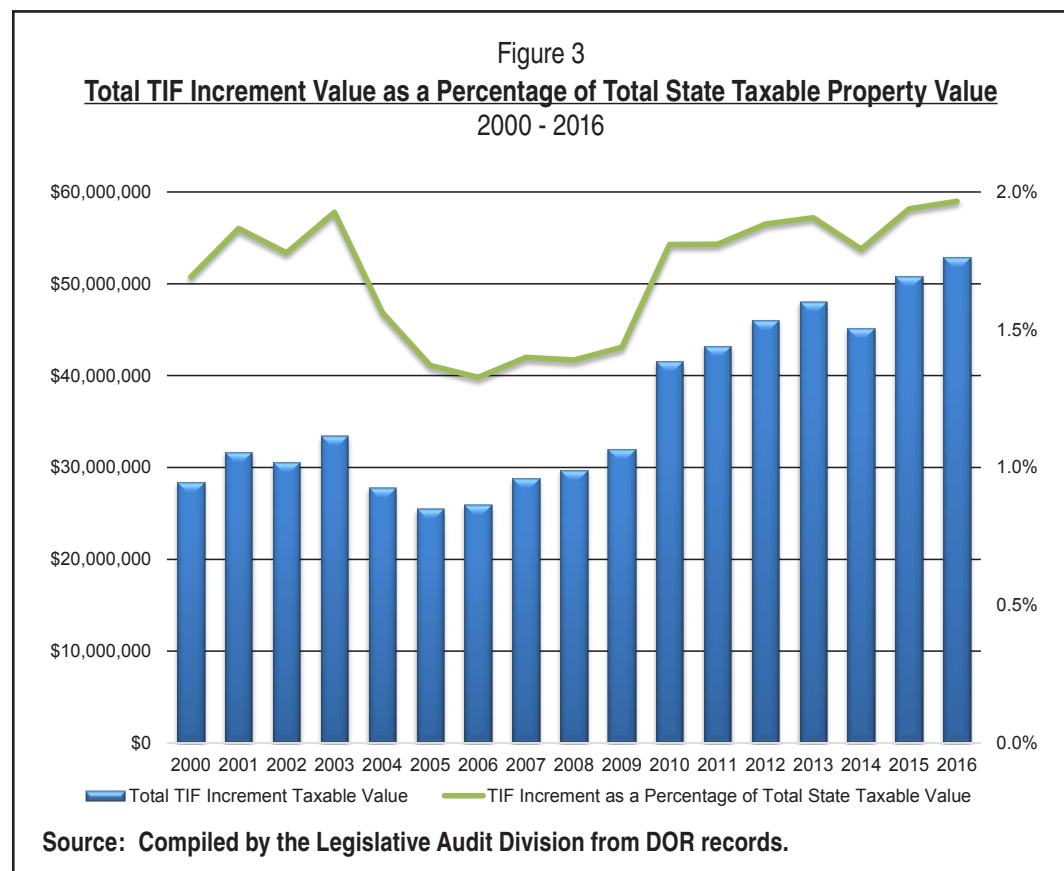
As of 2016, there are 55 active TIF districts in 18 different counties. There are currently 29 urban renewal districts (URDs) and 5 TEDDs. There are also 3 technology districts and 18 industrial districts, which were grandfathered in after changes in the Urban Renewal Law created TEDDs in 2013. Based on survey results from TIF district managers, the average expected expiration age of these active TIF districts is 21.6 years which is similar to past TIF districts that have since expired.

To date there have been at least 11 districts that have sunset, or expired, in Montana. Districts are sunset after they have been in existence for 15 years, the last bond payment is made after an extended period of up to 25 additional years (40 years total), or when

the city or county who created the districts ends them early by resolution. These 11 expired districts include 2 that were the result of the consolidation of 2 smaller districts.

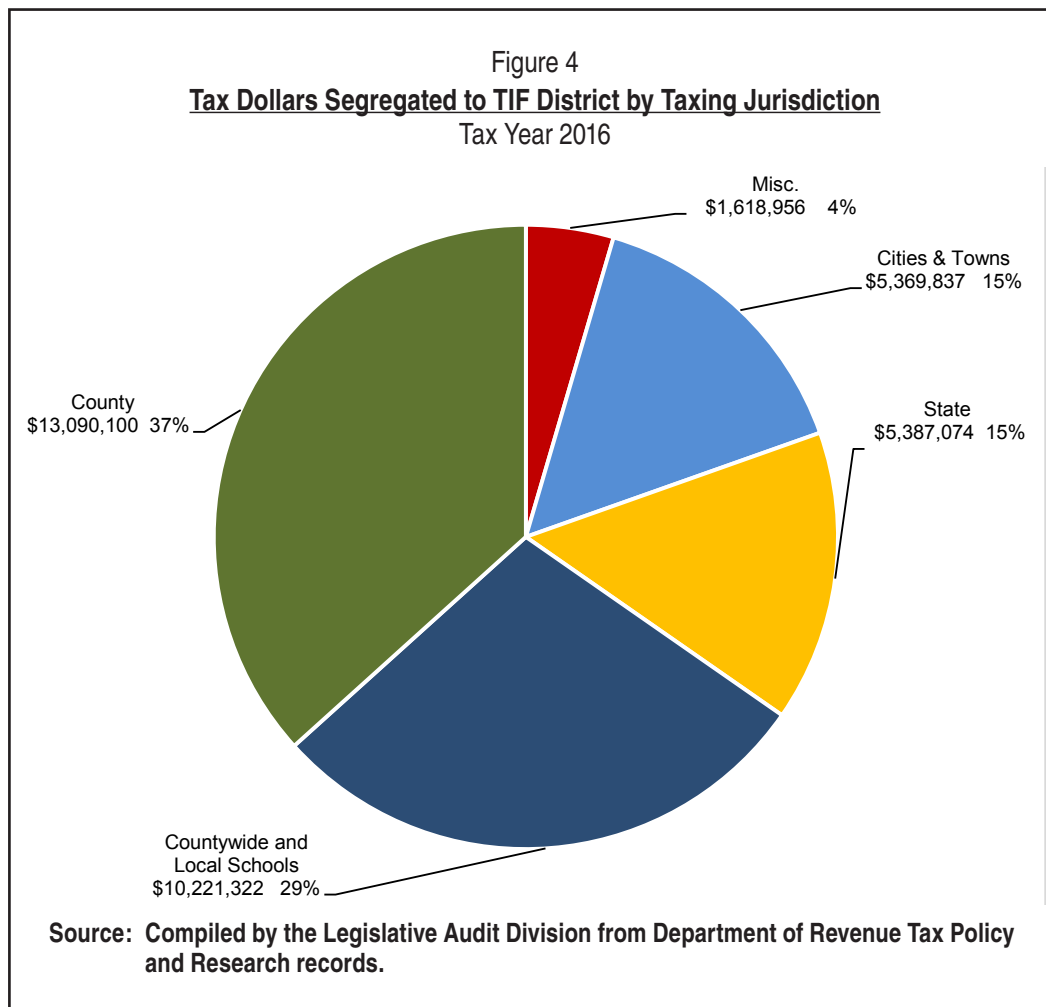
Growth of Tax Increment Financing

Legislators have expressed concern about the growth of TIF in Montana. We analyzed the extent of TIF use and whether or not its use has changed significantly over time. We also analyzed the relative growth of TIF by comparing the overall portion of taxable property value included in the TIF districts' increment compared to the total taxable property value of the state. The increment is the increase in taxable property value above the base value. This incremental taxable value is available to the TIF district for tax collection purposes. As shown in Figure 3, between 2000 and 2016 the total amount of taxable value in the TIF districts' incremental value has increased from approximately \$28 million to almost \$53 million. However, over the same time frame the total taxable property value in the state has increased by over \$1 billion. While total increment taxable value increased 86 percent from 2000 to 2016, its proportion to the state's total taxable value increased from 1.7 percent to 2 percent. This indicates that while the amount of total tax increment value has grown, it has remained relatively steady as a portion of total state property value.



The \$53 million of taxable value segregated for TIF districts for taxation purposes in 2016 does not equate to actual tax revenue for the districts. DOR estimates TIF districts generated approximately \$35.7 million in tax revenue based on the taxable value, or about 674.2 mills on average. In reality, TIF districts collect less than this due to under collection of tax revenue. For example, in one district a major taxpayer defaulted or intermittently paid their taxes during the past three years, equating to an underpayment of millions of dollars in tax revenue to that TIF district.

Taxing jurisdictions that levy mills on property value include cities and towns, counties, school districts, the state of Montana, and other specialized taxing districts. Because of this, not all of the \$35.7 million in tax revenue sent to TIF districts in 2016 would be collected by the state if TIF was not used, but the growth still occurred. Figure 4 shows the breakdown of where this revenue, if generated without the use of TIF, would have been distributed if it were not sent to the TIF district.

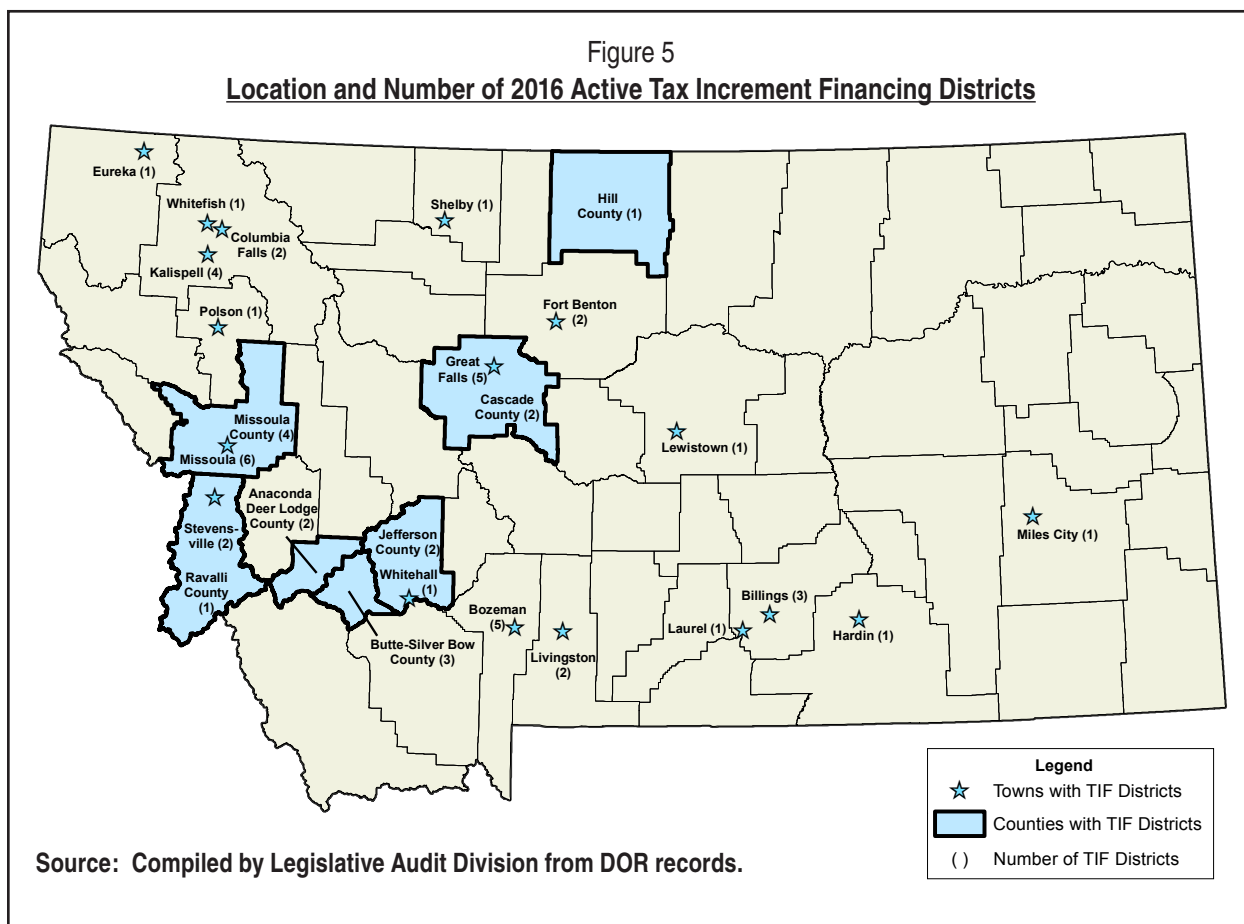


As displayed in this figure, all growth being assumed equal, DOR estimates property tax revenue generated by TIF districts that would otherwise be sent to the state general

fund, totaled approximately \$5.3 million. This is approximately 15 percent of the total amount of tax revenue sent to TIF districts in 2016. This confirms the state has a vested interest in TIF districts, but that other taxing jurisdictions comprise a larger portion of tax revenue sent to TIF districts. In 2016, local governments accounted for 56 percent of local property taxes that were sent to TIF districts around the state.

Location and Significance of Tax Increment Financing Districts

TIF is used throughout the state, but is more prevalent in the state's western half. The map below shows the distribution of TIF districts by county in 2016. It also illustrates if the TIF district is managed by a county or by a municipality, and the number of districts in each.



This map shows there are 7 counties, including 2 consolidated city-county governments, that manage their own TIF districts. Municipalities are more likely to have TIF districts, with 18 municipalities including at least one.

Tax Increment Financing District Increment, as Percentage of the Local Government's Total Tax Value, Differs Considerably

Determining what proportion of an area's total taxable value is part of a TIF district is one method to measure the relative extent of TIF use in a local community. This provides a comparison on the extent of use and amount of tax increment diversion between different communities. We took the overall reported taxable value for each local government as provided by DOR's Tax Policy and Research (TPR) office and divided it separately by the total base and increment values of TIF districts in each local government as reported in DOR's 2016 certified values. Table 2 (see page 17) shows these values.

Table 2
Total Base and Increment Value of TIF Districts Within Local Governments
 Tax Year 2016

Local Governments with a TIF District(s)	Base as Percent of Total Local Government Taxable Value*	Increment as Percent of Total Local Government Taxable Value**
Anaconda-Deer Lodge	8.9%	36.3%
Billings	6.7%	4.9%
Bozeman	5.6%	4.6%
Columbia Falls	30.0%	1.8%
Eureka	28.2%	2.3%
Fort Benton	9.4%	3.5%
Great Falls	4.8%	1.5%
Hardin	10.0%	31.4%
Kalispell	21.4%	3.1%
Laurel	13.7%	11.2%
Lewistown	23.0%	0.5%
Livingston	14.3%	3.0%
Miles City	18.1%	0.0%
Missoula	12.0%	3.7%
Polson	15.2%	4.8%
Shelby	2.2%	6.8%
Stevensville	6.7%	0.3%
Whitefish	13.8%	27.8%
Whitehall	64.6%	4.0%
Butte-Silver Bow	8.5%	11.5%
Cascade County	0.0%	0.1%
Missoula County	0.1%	1.4%
Hill County	0.0%	0.0%
Ravalli County	0.1%	0.0%
Jefferson County	2.5%	4.0%

Source: Compiled by the Legislative Audit Division from DOR data.

* Zero percent values indicate that the property value of the base is so low relative to the rest of the property in the area that it does not register above 0.1%.

** Zero percent values indicate there is not an increment value large enough to register above 0.1% of the total local government property value.

The second column of the table shows what portion of a TIF district's base value is part of its local government's total taxable value, which is an indicator of what portion of a local government's taxable value was originally included in a TIF district's area. Higher values indicate the TIF district was created to include a large amount of the higher-value property in the area or more property overall. For example, Whitehall's district

base value contains 64.6 percent of the total value of the town within its boundaries, showing it included some combination of most of the property in the town, or more of the higher value property in the town. Lower values show that relative to the rest of the community, there was little to no valuable property included in the district. This is more often seen in counties as the total portion of a county put in a TIF district is usually small relative to the overall size of the county, and often starts with undeveloped land. For example, Cascade County has two TIF districts, but the total base value of these districts is so low that it is less than 0.1 percent compared to the county's total value.

The third column shows how much incremental taxable value is used for taxation purposes to the TIF district relative to the total taxable value of the community. High percentages of property contained in an increment indicate property values in the districts have greatly increased since the district was created. It also means there is a larger portion of the local government's taxable value unavailable for taxation by other jurisdictions. Of the five local governments with over 10 percent of their value in an increment, four TIF districts have either released portions of its revenue back to other taxing jurisdictions, or not received the increment due to tax delinquency. Lower values indicate the incremental value accumulated in this area's TIF districts are small relative to the total area taxable value. This could mean the TIF district is new, it is relatively small compared to the rest of the area, or it has generated limited to no incremental value. Districts with no tax increment do not receive any tax revenue.

Creating and Managing Tax Increment Financing Districts in Montana

Legislators have expressed interest in local reasons for using TIF and how districts are organized. Our audit included a review of how TIF districts are created and managed once they are operational. The Urban Renewal Law provides the statutory authority for local governments to create development districts and use TIF as a financing provision. This law includes guidance regarding the appropriate justification for creating TIF districts, but is broadly permissive in how local governments can structure and manage TIF districts. We surveyed TIF district managers to determine if the reasons for creating TIF districts align with statutory goals and identify the different management structures used for districts around the state. We received responses for 54 of 55 TIF districts, a 98 percent response rate.

Reasons for Creating Tax Increment Financing Districts

According to survey results, the most common reasons for using TIF to finance development districts coincides with statutory goals for URDs and TEDDs, which indicates TIF districts are being created for statutorily intended purposes. For example,

the top three reported reasons included improving or maintaining infrastructure (81 percent), combating blight (74 percent), or increasing local jobs (59 percent). Additionally, 59 percent of respondents claimed they created the TIF district to stabilize or increase a declining tax base. Although increasing property tax base is not explicitly a goal of Montana's TIF statutes as outlined in Title 7, Section 15, Parts 42 and 43 of the Montana Code Annotated, the underlying theory of TIF is based on the idea that investment will generate future increases in property value that would not have occurred otherwise. This increase is what should generate the additional tax revenue to justify the funds staying within the TIF district, instead of being distributed to other taxing jurisdictions. Contrary to this assumption, survey results found 41 percent of TIF districts were not initially created with the intent to eventually increase property values.

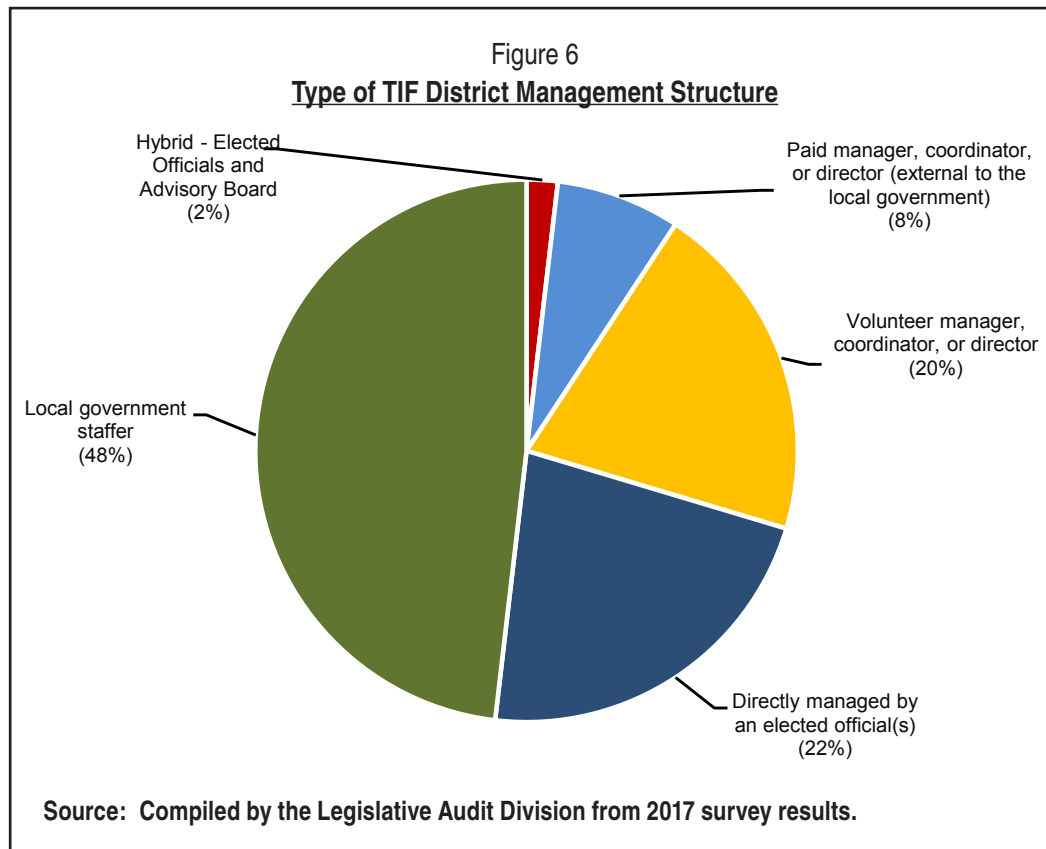
Public Process in TIF District Decision Making

Decision making within TIF districts is subject to a number of statutory requirements in both the Urban Renewal Law and general local government statutory provisions. In order to create a URD or TEDD, the sponsoring government entity must pass multiple ordinances and resolutions prior to setting up the district, all of which require meetings open to public comment. Additionally, the district's urban renewal or comprehensive development plan must be subject to a public hearing prior to its adoption. According to §7-6-4021, MCA, once the plan is in place, if a local government wants to conduct renewal activities on an annual basis they must include them in the local government's annual budget.

In addition to statutory requirements, most TIF districts also include additional public processes to reach out to taxpayers throughout the life of the district. Communities notify the public of TIF meetings using a variety of measures, including notices in local newspapers, local government websites, or posting notices in public buildings.

Management Structures of Tax Increment Finance Districts

Statute does not require any one way of managing a TIF district. Therefore, there are a number of different methods used by local governments to administer their TIF districts according to local needs. Figure 6 (see page 20) shows self-reported management structures based on survey responses we received from TIF district managers for 54 of the 55 TIF districts.



As illustrated, TIF districts are typically managed by a local government staff person, such as a director of community development, a city finance officer, or the director of an urban renewal agency. Other common management structures involve direct management by elected officials or volunteer managers. Paid external consultants are used to manage only four districts, three of which are located in a single city.

The majority of TIF districts (78 percent) also have a managing board in place ranging from three to ten or more volunteer members. Twenty percent of TIF district boards consisted solely of community volunteers. The remaining TIF district boards included positions with representation requirements from affected taxing jurisdictions, such as the county or the school district. Boards most frequently included at least one local government elected official. There are no statutory requirements regarding the compilation of TIF district boards, except for §7-15-4234, MCA, which specifically requires urban renewal agency boards consist of five members with four-year terms.

Involvement of School Districts Within a Tax Increment Financing District

Legislators have raised questions about the extent other taxing jurisdictions, specifically school districts, are involved in the creation of and administration of TIF districts.

Section 7-15-4282, MCA, requires a TIF provision “take into account the effect on the county and school districts that include local government territory” and §7-15-4284, MCA, specifies a copy of each plan, ordinance, or amendment pertaining to TIF districts be filed with the clerk or other officer of the affected taxing bodies. It does not specify the district specifically notify the other taxing jurisdictions of the decision-making meetings. Despite this, overall survey results and interviews found local governments consistently notified and involved potentially affected taxing jurisdictions when starting the process of creating a TIF district. However, many TIF district managers stated they did not involve other taxing jurisdictions in additional administrative decisions, partially due to a lack of interest from other administrators. For example, local TIF managers claimed local school district administrators are often not interested in attending meetings after learning of changes made to §7-15-4201, MCA, by the 2015 Legislature which affected TIF remittances to school districts. To verify this assertion, we interviewed Office of Public Instruction’s School Finance Division staff to determine what effect TIF has on school funding. These interviews and additional statutory review found that because of Montana’s school funding formulas, schools have the authority to levy mills to meet their statutorily determined budget limits. As a result, the diversion of the incremental value to TIF districts has little-to-no effect on their funding.

CONCLUSION

Though local governments are using a variety of ways to manage TIF districts across the state, including the extent to which they involve other taxing jurisdictions, they appear to be following the public notice and involvement requirements.

Use of Tax Increment Financing Funds

Expenditures that can be paid using funds generated with TIF have been subject of much interest in recent legislative sessions. Currently, there are limited restrictions on the use of TIF funds. Statute gives local governments flexibility in how they use the funding so long as they follow the prescribed public processes required of local government functions. Although to date districts have not been mandated to report expenditure information to any state agency, 2017 legislative changes require they include some expenditure information in future annual financial reports sent to the Department of Administration.

Though there are restrictions on the use of TIF funds, statute provides broad authority to local government on how they can use the funds. State law requires projects using TIF funds be identified by the local urban renewal or comprehensive development

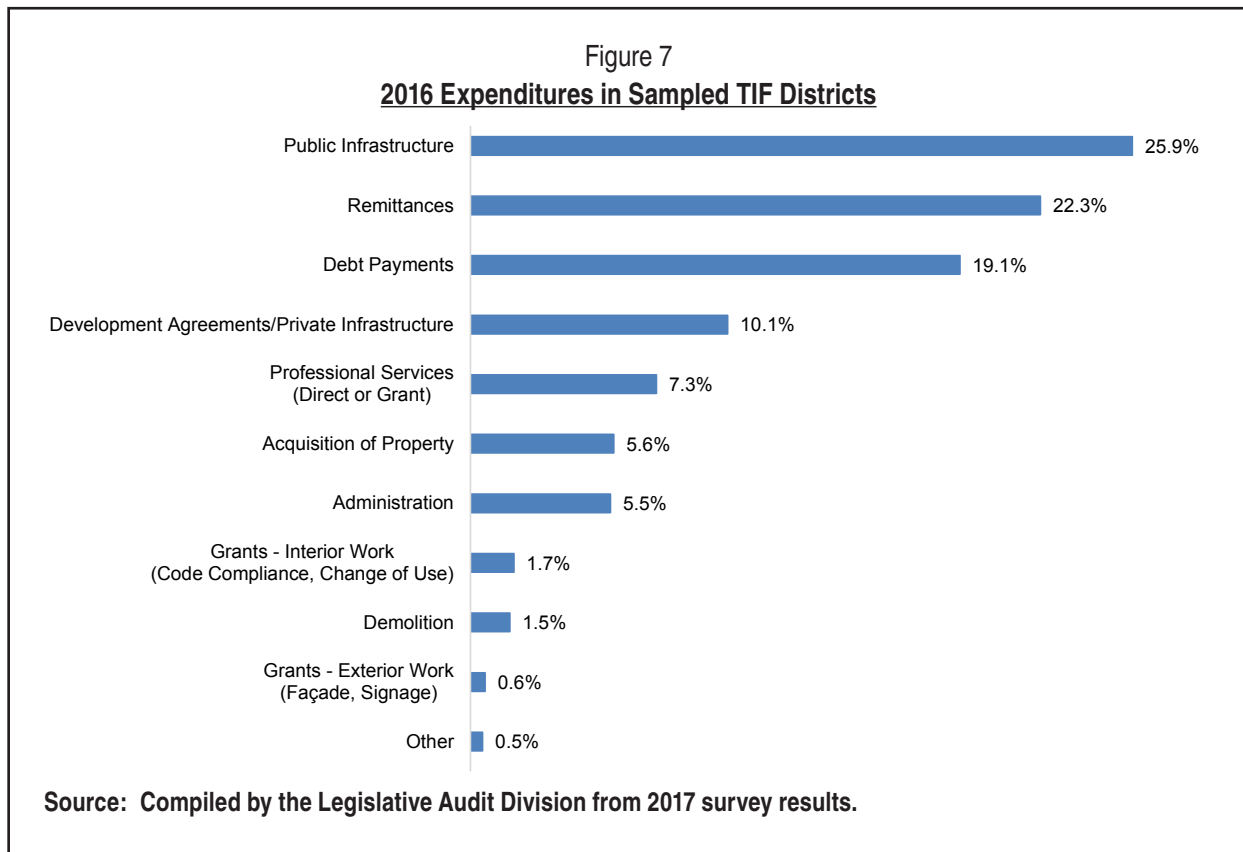
plan. In addition, statute also requires TIF funded projects be conducted inside the boundaries of the district, unless they connect the district to external infrastructure. Statute also provides a list of specific costs that may be paid by TIF, such as land acquisition, demolition of structures, improvement of public infrastructure, certain administrative costs, and direct assistance to secondary value-adding industries to meet infrastructure needs. In addition, it states URDs can pay costs incurred as a result of redevelopment activities allowed in §7-15-4233, MCA. This section allows for the elimination and prevention of blight as required by the local governing body, so long as it is in accordance with the local urban renewal plan. TEDDs, however, are more restricted in their use of TIF funds. According to §7-15-4278, MCA, with respect to TEDDs, the legislature declared the TIF laws should be used to encourage the creation of areas in which needed infrastructure for value-adding industries could be developed.

Additionally, questions have arisen regarding the ability of public funds, such as TIF funds, to be provided to private entities. The Montana Attorney General indicated that although public funds must be used for a public purpose as stated in the state's constitution, the recipient may be a private entity. When asked for guidance by a city attorney, in 1988 the Attorney General opined a grant of TIF funds to a private, nonprofit corporation to demolish a structure and construct a parking lot for public use was allowable because the funds were being used for both expenses included in §7-15-4288, MCA, and for a public purpose.

Use of Tax Increment Financing Funds Meets Statutory Requirements

Legislators have expressed concern about how TIF funds have been used by different local governments. As part of our audit work, we collected expenditure reports from the TIF districts in our eight sampled counties. We then categorized the expenditures to provide an example of what TIF district funds are spent on in a year. Expenditures of districts may vary depending on the age of the TIF district, so this categorization may not be reflective year by year. For example, older districts may have a larger portion of debt expenditures compared to younger districts. Overall, 23 of the 34 TIF districts included in audit site visits provided their 2016 expenditures, with total expenses over \$23.2 million, \$5.2 million of which was remitted (i.e. paid) back to other taxing jurisdictions. Not all local governments operate on a fiscal year ending on June 30th, so some districts reported expenditures based on the calendar year. Based on the categorized expenditures, we determined local governments primarily use TIF funds to

combat blight and infrastructure deficiencies, mainly through a combination of public infrastructure projects and grants. Figure 7 shows these expenditures by category.



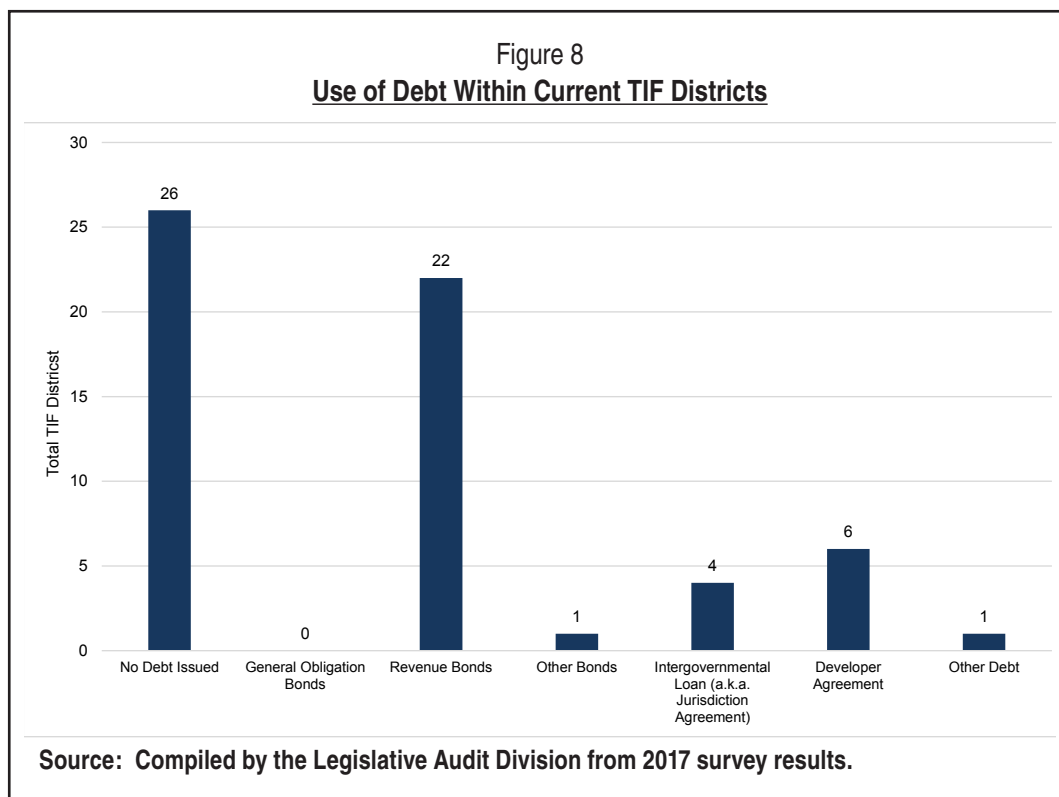
As shown, a majority of TIF districts used funds to pay for public infrastructure. Approximately 34 percent of all expenditures relate to public and private infrastructure work, such as for roads and utilities. Another 19 percent are used to pay debt service issued for major infrastructure projects. The next largest use of funds was for remittances, with 22 percent of all expenditures paid back to affected taxing jurisdictions. Though some TIF districts, particularly those in historic areas, provided grants to private property owners for projects such as façade work, code compliance, or property change-of-use updates, the overall volume of these expenditures were low relative to other projects. Expenditures labeled as “other” did not fit in any of the other categories. For example, \$25,000 of this category was from a downtown TIF district to pay a portion of the salary for a police officer hired to patrol only the downtown area. Other expenses included a park maintenance program, maintenance for a public garage, the purchase of barricades and event signs, and a contribution to help pay for the maintenance of a train horn quiet zone in a downtown area. Though these expenses do not meet the specific costs allowed to be paid by TIF in §7-15-4288, MCA, they are included in the local urban renewal plan, and they relate to broad statutory goals in the Urban Renewal Law such as increasing public safety.

CONCLUSION

There are few statutory guidelines on the implementation methods and appropriate use of TIF funds, particularly for urban renewal districts. This results in local governments using TIF funds under the direction of their local governing body in diverse ways to fulfill local development goals. Overall, TIF districts are using the majority of TIF funds in accordance with the more restrictive allowable costs cited in §7-15-4288, MCA. Additionally, projects appear to relate to the broad statutory goals laid out for development districts in the Urban Renewal Law.

Debt Financing Within Tax Increment Financing Districts

TIF districts can issue debt when approved by ordinance of their local government authority to finance and complete projects. Survey work found it is common practice for TIF districts to use various types of debt to complete a project upfront. TIF districts then pay the debt with increment revenue over the life of the district. Figure 8 details how many TIF districts are currently using each type of debt financing.



As illustrated in the figure, about half of the TIF districts have used debt to finance projects. The use of revenue bonds is most common among districts that issue debt. Revenue bonds are secured by anticipated future increment revenue in the TIF district.

To issue bonds, the local government contacts bond counsel to ensure the legal documents and processes are completed correctly. Typically bond agreements require a reserve fund be created to help prevent bond default if revenue is unexpectedly low. Survey results and site visits found only one TIF district has ever defaulted on its bond. While local governments are not required to make the bond payments out of their general fund, they may experience a decrease in their credit rating from independent rating agencies if they default on a TIF district revenue bond.

Other types of debt financing may be used in place of, or in conjunction with, bonds. A common means of financing development in TIF districts is through development agreements. Development agreements are formal arrangements with private developers to pay the public infrastructure costs associated with their development project upfront, with the promise of repayment from future district revenue. These agreements are often interest-free and include payback provisions if the development is not completed according to specifications, or if the project does not produce the expected increase in tax revenue. A less common means of issuing debt to TIF districts is through intergovernmental loans. With these loans, the general fund or special fund of a local government may agree to pay for projects on the condition they are paid back with future tax increment revenue.

Tax Increment Remittances to Other Taxing Jurisdictions Are Uncommon

Historically, TIF districts have provided payments to affected taxing jurisdictions, particularly school districts, when they have unneeded balances. These payments are commonly referred to as remittances, and formal agreements to provide these payments are referred to as remittance agreements. In the past, the use of remittances to school districts has been the subject of controversy and a lawsuit due to schools putting the funds in a flexible spending budget for capital construction, which some felt resulted in double taxation of entities within the TIF district and also contributed to inequity between school districts statewide. In response, the 2015 Legislature passed HB114, which amended §§20-9-104, MCA, and 20-9-141, MCA, to require school districts use TIF remittances in specific funds, which must then have a corresponding reduction in future mill levies in the amount of TIF funds received. As a result, there is decreased interest in future remittance agreements. The Office of Public Instruction tracks the receipt of TIF remittances by schools and found that in 2016 four school districts received remittances totaling \$2.76 million. Interviews with managers and local government officers found they do not plan to create new remittance agreements with school districts in the future due to the requirements of HB114. Instead, some TIF districts now include school districts within the TIF district to directly complete urban renewal projects on the school, similar to how they currently conduct projects on other

public property in the district. These projects are allowable uses of TIF funds based on §7-15-4288, MCA, which allows for the improvement of public improvements (buildings).

Chapter III – State Administration of Tax Increment Financing Is Not Defined

Introduction

As part of our audit work, we assessed the Department of Revenue's (DOR) role in implementing tax increment financing (TIF). Although TIF was enacted in 1974, until recently DOR had only a minor role in its administration. The Urban Renewal Law allows local governments to use TIF, but does not establish clear responsibilities regarding the state's role in administering it apart from where DOR's existing tax administration authority already existed, such as in property assessment. Because of this, the primary responsibility over TIF is on local governments, and DOR's involvement in TIF is not clearly defined. However, over the past decade, DOR's role has grown as a result of changes in statewide TIF use and reactions to observed administrative deficiencies, such as a need to make sure the district area is comprised of contiguous parcels of property. We determined multiple offices and divisions within DOR now have a role in administering TIF activities. However, this has resulted in inconsistencies in how TIF is administered by DOR because roles need to be better defined. Unclear statute has contributed to the issues discussed in this chapter, and will be further addressed in Chapter IV.

This chapter discusses the legal authority of DOR in TIF administration and addresses needed improvements to its role. Areas addressed include:

- ◆ Inconsistent requirements for approval of qualified TIF districts,
- ◆ Inaccuracies in certification of property values in TIF districts,
- ◆ Insufficient guidance to treasurers to ensure tax revenue is accurately allocated,
- ◆ Limited compilation or retention of TIF district information, and
- ◆ Needed improvements in establishing and communicating TIF expectations.

Department of Revenue Plays Minimal Role in Tax Increment Financing Administration

As previously stated, the responsibilities and authority of DOR over tax increment financing are not clearly established in the Urban Renewal Law. However, there is broad statutory authority given to DOR regarding administration of activities related to TIF. In particular, pursuant to §15-1-201, MCA, DOR has "general supervision over the administration of the assessment and tax laws of the state... and over any officers of municipal corporations having any duties to perform under the laws of this state relating to taxation." Additionally, DOR is directed to "confer with, advise,

and direct officers of municipal corporations concerning their duties, with respect to taxation, under the laws of the state.” Despite broad statutory authority, DOR did not seek additional direction, nor conduct duties beyond certifying district values for the first 34 years of TIF use in Montana. DOR did promulgate rules in 2008, however the department’s role can be better defined, and it can further develop department policy and organizational duties for the administration of TIF. Consequently, DOR’s role continues to be unclear despite 43 years of TIF existence in the state.

Challenges to the Department of Revenue’s Administrative Role

In 2008, DOR began to define its role in TIF by implementing administrative rules to outline what documentation local governments need to provide the department for TIF district approval. This resulted in lawsuit where a county whose proposed TIF district was denied by DOR challenged the department’s authority to create rules and deny the creation of districts. The Supreme Court ruled DOR does have the authority to promulgate rules and create or deny districts because TIF is inherently related to taxation. In further clarification of DOR’s role in approving TIF districts, a 2009 amendment to §7-15-4285, MCA, requires DOR to calculate and report the base, actual, and incremental taxable values to the local government and other affected taxing jurisdictions “upon receipt of a qualified tax increment provision.” This further confirmed DOR’s role in determining whether to approve districts that collect TIF revenue. Despite the Court’s ruling confirming DOR’s authority to administer TIF, the department has not taken any additional steps to define their role or develop policy to clarify their role.

In 2012, DOR refused to certify values for an existing TIF district in Anaconda-Deer Lodge County. DOR claimed the district was capturing, rather than creating, growth. They also alleged that remitting TIF funds to the local school district’s flexible spending account constituted double taxation on taxpayers within the TIF district, because remittances were not used to lower school district mill levies. Ultimately, a District Court determined if DOR found the TIF district unqualified, it should have pursued the issue prior to initial approval. The court also found DOR’s authority does not include control over how counties and school districts establish and use their budgets.

State Law and Administrative Rules

Guide Approval of TIF Districts

As a result of DOR’s need for specific information prior to establishing new districts or amending existing districts in its property assessment system, it adopted rules to review and approve districts. ARM 42.19.1402 to .1404 require local governments

file a list of specific documents with DOR's Legal Services by February 1st of the calendar year following the creation or amendment of the TIF district through local government ordinance. These documents differ depending on whether the district is a URD or a TEDD, but includes items such as:

- ◆ Documentation of which blight or infrastructure deficiency was determined to justify the creation of the district.
- ◆ A map and legal description of the boundaries of the district.
- ◆ A copy of the urban renewal plan or comprehensive development plan with a TIF provision.
- ◆ A copy of the notice of the public hearing.

A department attorney reviews the packet to determine if required documentation is included. Staff stated the qualification of the TIF district is not assessed outside of the submission of the required documentation. If the packet is complete, DOR's director sends a letter to both the local government and the department's Property Assessment Division (PAD) indicating the TIF district was approved; thus beginning the certification process. If the packet is not complete, but the error is discovered prior to the February 1st deadline, the Legal Services Office requests additional documentation. If the error is discovered after the February 1st deadline or otherwise cannot be fixed in time for DOR to successfully create the district, they send a rejection letter indicating why the district was rejected.

Tax Increment Financing District Approval Process Is Inconsistent

As part of audit work, we reviewed 28 TIF district packets approved between 2010 and 2016 to determine if districts were created in accordance with state law. Packets reviewed included 21 that created new TIF districts and 7 that expanded the boundaries of an existing district. We noted the Legal Services Office either did not always have the necessary documentation for districts required for approval, or requested local governments to submit documentation that was not required by ARM. The following discuss our findings:

- ◆ Seven percent of the TIF packets did not include a required list of property codes within the boundaries of the TIF district. Though ARMs 42.19.1403 and 42.19.1404 require a list of property codes be included, DOR staff indicated local governments do not have the ability to collect accurate records. Instead, staff stated Legal Services is usually notified when a district is in the process of being created and coordinates with PAD and DOR's Business Income Tax Division (BIT) to compile the data for districts. However, no published guidance indicates local governments should contact DOR for this data prior to the submission deadline.

- ♦ An approved TIF district where documentation did not include a local commission finding that the district could host multiple tenants, which is required under §7-15-4279, MCA, and ARM 42.19.1404.
- ♦ One district was approved despite documentation not reflecting it met the public notice requirements in §7-15-4215, MCA.
- ♦ Documentation not required in rules was often requested to prove the local government met statutory public hearing requirements. ARM 42.19.1403 to .1404 require only a copy of the notice of the public hearing, but Legal Services requested additional necessary documentation, such as:
 - ◇ An affidavit confirming publication of the notice, complete with dates,
 - ◇ Addresses of property owners in the district, and
 - ◇ A receipt of mailing sent to property owners.

However, the request and receipt of these additional documents was inconsistent. Five approved TIF districts or district amendments did not include an affidavit, seven did not include a list of property owner addresses, and seven did not include mail receipts.

These examples indicate there is a disconnect between statutory requirements and administrative rules. While state law requires public notice for the hearing to approve the district be provided at least ten days in advance and notice be mailed to all property owners within the district, administrative rule does not require the local government provide documentation of meeting these requirements. In addition, administrative rule only requires a copy of the notice of public hearing, which in some cases included an illegible scan of a newspaper clipping or a copy of the wording that was used in the publication. This documentation does not ensure TIF districts are meeting public notice requirements when they are approved by DOR.

DOR can improve its TIF approval process and requirements to ensure both the legality of certified districts and consistency in the approval process. As discussed, DOR has not standardized what documentation or additional factors they will consider in determining TIF district qualification. This includes not consistently requiring or reviewing additional documentation relating to the public process requirements. Within the current process, there are no guidelines apart from administrative rule to communicate to local governments the specific requirements for approval and the documentation required for the district approval process is inconsistent.

RECOMMENDATION #1

We recommend the Department of Revenue:

- A. *Update tax increment financing administrative rules to require local governments submit documentation that demonstrates they met statutory requirements when creating TIF districts, and*
 - B. *Develop and implement policies and procedures to accurately communicate deadline requirements to local governments.*
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Certifying Tax Increment Financing District Property Values

Pursuant to §15-1-201, MCA, DOR is the entity responsible for the assessment of property values statewide. Property assessment, which includes calculating and certifying the official property values for each taxing jurisdiction on an annual basis, is completed by PAD. Taxing jurisdictions use this value to determine what tax rates they need to fulfill their budget requirements and not exceed statutory limits. This responsibility to assess property is expanded in §7-15-4285, MCA, to include the calculation of the base and incremental property values for a qualified TIF district. This calculation is done both at the district's initial creation and each succeeding year. ARM 42.19.1407 further requires PAD to determine the value of the TIF district as of January 1st of the calendar year in which the district was created, if submitted to DOR by the February 1st deadline in the following calendar year. The incremental value is then calculated by deducting the base value from the actual property value each following year on January 1st. PAD annually reports these values to all affected taxing bodies by the first Monday of August in certified value forms. Based on a review of certified value documentation; surveys of department staff, TIF managers, and local government financial officers; and interviews with department staff and local district managers, we found the certified values of TIF districts are often misreported.

Incorrect Tax Increment Financing Certified Values

During our audit work we reviewed certified value forms for local governments with TIF districts from 2011 through 2017 and found instances in which incorrect base values were corrected by PAD, sometimes years after values were first certified. We identified these incorrect values by reviewing base values from year to year to determine

if the values changed for reasons other than changes to the districts' boundaries. The following provides examples of issues we identified:

- ♦ In one county, PAD incorrectly attributed \$14,424 in taxable value for two years to base value rather than increment value in a TIF district. In the same county, a personal property record was also incorrectly excluded from the TIF district for three years before PAD realized the value belonged in the TIF district.
- ♦ PAD incorrectly attributed all centrally assessed property in a TIF district as incremental value, when a portion should have been included in the base value. This resulted in \$768,465 of taxable value incorrectly attributed to the increment. In this case, the district was required to reimburse \$490,162 of tax revenue to the county for redistribution because of this incorrect certification.
- ♦ A municipality discovered \$466,932 of incremental value in its TIF district was incorrectly certified as newly taxable value for the city. Consequently, the city had to recalculate their maximum mill levy for the year to ensure it had not overtaxed its citizens due to this error.
- ♦ Two TIF districts were provided incorrect base values, one over the correct value by \$324,818 and another under the correct value by \$133,862.

We conducted two surveys, one of local government staff and one of PAD employees involved in TIF administration, to obtain opinions on the administration of tax increment financing. Local government staff with TIF district responsibilities responded district assessed values were only sometimes accurate (42 percent) or rarely accurate (10.5 percent). One third also indicated they were uncertain of what actions they should take to ensure values were fixed in the event of a possible miscalculation. Interviews with TIF managers in our sample of counties further noted concerns with the accuracy of TIF district certified values. TIF managers stated it was difficult to get answers regarding value discrepancies, particularly for centrally assessed and industrial property. The survey of DOR's local PAD staff confirmed problems with certified values exist. PAD staff indicated there were issues with TIF certified value accuracy, with 32 percent believing base values were very inaccurate, and 29 percent believing increment values were very inaccurate.

Errors in the certification of values of TIF provisions can result in a number of complications. If errors result in under-collection of tax revenue or the retroactive reallocation of tax revenue, it could affect the services provided by a taxing jurisdiction and threaten the ability to fulfill contractual obligations, such as bond payments. Additionally, correcting such errors can place resource and time burdens on both the local government and DOR staff. Local governments are also put at risk of not meeting their statutory deadlines for setting mills and issuing tax bills. For example, a local financial administrator provided documentation of issues with certified values

over the course of several years. They indicated this threatened the ability of the city to meet its statutory deadlines and often required city staff to redo work based on the incorrect values.

Lack of Consistent Review of Certified Values

Each year PAD sends a document to regional staff guiding them on how to certify taxable values. Included in this document is the requirement that a manager signs off on all certified value forms prior to submitting them to the local government. However, this document does not provide direction on how to verify TIF district values prior to their submission. Interviews and survey results found the review of TIF value accuracy varies between area and regional PAD offices. For example, almost 54 percent of PAD survey respondents said certified values are not verified by anyone other than the person who calculated the values, 23 percent stated a second employee checks to make sure the increment appears correct, and 19 percent indicated a manager conducts an in-depth review of TIF base and increment values. These survey results were confirmed by interviews with staff in county PAD offices that described a lack of consistency in TIF value review. We recognize DOR has been impacted by recent state budget issues. As a result, PAD has recently eliminated staff in field offices across the state, which increases the burden on existing PAD staff to conduct their current responsibilities.

Once the values are submitted to the local government, local staff have reported issues with identifying a point of contact at DOR to discuss possible valuation errors. Local government staff do not have access to enough valuation data to double check the values, and must rely on DOR staff to explain unexpected changes in district valuation. Interviews with local government and property assessment division staff indicate there is no clear process to address disputes from local governments regarding certified value errors. For example, when local government staff have questions about industrial property values in TIF districts, some have been told contacting the industrial assessor requires a cumbersome process that would exceed required tax deadlines, while others have directly contacted the centrally located staff themselves. While Helena based PAD staff confirmed there is a formal process for their staff to contact centrally assessed and industrial appraisers, a manager within BIT claimed there was no formal process. Because of this discrepancy, some local government entities are able to address concerns about values while others are not. This is an indication of a lack of a central point of contact for local staff, and a disjointed process overall for handling TIF administration issues.

RECOMMENDATION #2

We recommend the Department of Revenue improve certification of tax increment financing taxable values by:

- A. *Developing and implementing a process to verify certified base and increment values for TIF districts before sending them to local taxing jurisdictions, and*
 - B. *Defining formal lines of communication between local governments and the department for questions relating to TIF district values.*
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Tax Increment Should Be Distributed Based on Statutory Requirements

Under §15-1-201, MCA, DOR has general supervision over the administration of property valuation and tax laws of the state, including over officers of municipal corporations with duties relating to taxation. In Montana the county treasurer is responsible for collecting and distributing tax revenue based on the valuation data provided by DOR. Once collected, §15-1-504, MCA, requires the treasurer to remit all tax belonging to the state to DOR. To manage the collection and distribution of tax revenue, treasurers often use a tax billing software to issue tax bills and calculate what revenue should be sent to which taxing jurisdictions. In Montana there are currently two different companies offering this software to treasurers, and both have an additional software add-on to handle the special calculations of TIF district revenue.

Methods of allocating tax revenue to TIF districts is defined by state law. In §7-15-4283, MCA, an incremental taxable value is defined as “the amount, if any, by which the actual taxable value at any time exceeds the base value of all taxable property within an urban renewal area or targeted economic development district.” This means that the incremental taxable value, and thus the tax revenue generated from this value, should be based on the overall amount by which the taxable value in the district exceeds the original base value. Thus, values should not be determined on a parcel-by-parcel basis. We found issues in allocating tax increment revenue based on these statutory guidelines and determined there is a risk errors are going undetected. As a result, the taxing jurisdictions in areas with TIF districts, including the districts themselves, may not be receiving the proper amount of tax revenue to provide local services.

Tax Increment Revenue Incorrectly Distributed

Past issues with the distribution of tax revenue by a county tax-billing software program indicate a high risk for widespread distribution errors. DOR staff stated they are aware this software has calculated the increment values of property in TIF districts on a parcel basis rather than for the entirety of the district, which causes issues when there is no increment, or when property changes in the TIF district. Four of the eight counties selected for site visits found county treasurers using this particular tax-billing software. Two of these counties have experienced issues with the software calculating a negative increment for the district, which is not possible as the lowest increment for a district is zero. The software has instructed some local governments to backfill their general fund from the TIF fund as if they had collected tax on the base property value. In one case, the district backfilled the general fund even though it had never received an increment or completed a project, thus ending up with a negative account balance. Two other county treasurers noticed issues with how the software was calculating increment values, and as a result, at least one created their own means of distributing TIF district revenue.

The full extent of these allocation errors is not certain. DOR does not have access to these local systems to identify when there are issues with the allocations. Staff also stated they are uncertain of what their responsibilities are regarding tax collection and distribution by county treasurers.

A 2014 Legislative Audit Division financial-compliance audit found DOR was not confirming the accuracy of nonlevy property revenue, such as coal gross proceeds revenue. To do so, DOR had to begin to differentiate the nonlevy revenue from levy property revenue, such as the 55 mills levied for education equalization purposes sent to the general fund. In 2017, DOR's Tax Policy and Research (TPR) office began the process to verify both the levy and nonlevy revenue collected for tax year 2016 against assessed property value estimates for that year. They are currently in the process of determining the accuracy of these values. Even if the values collected are inaccurate, staff have expressed reservations regarding their statutory authority to direct county treasurers to ensure accurate distribution of property tax revenue.

Local Government Staff Should Be Guided on How to Improve Tax Allocation Accuracy

Statute requires that both the TIF base and increment be based on the overall value of the district, not on a parcel-by-parcel basis. Some counties have purchased an additional add-on software module to help calculate these values so they do not have to be done manually; however, one module is not correctly set up to handle TIF nuances

unique to Montana. This tax billing software has been calculating the tax increment on the parcel level. Additionally, site visits found some local government staff were not aware this software program was incorrectly allocating tax increment revenue. The software vendor recently initiated talks with DOR to discuss these issues and make some improvements, but counties continue to report they are having issues.

Presently, DOR has not developed an alternative method for counties to distribute their tax increment if their tax-billing software is not working. When DOR or the county notices issues with the tax-billing software that are not corrected, some counties have continued to use the software while others have tried to set up their own methods of correcting the issues outside of the software program. DOR could develop and communicate a formula or spreadsheet based on statutory requirements for counties to use to distribute the tax increment based on the district-wide values of the districts.

RECOMMENDATION #3

We recommend the Department of Revenue guide and support county treasurers by developing an alternative method to calculate tax increment revenue according to the district-wide increment and base values of tax increment financing districts.

Tax Increment Financing Information Has Not Been Maintained

Best practices related to TIF established by the Government Finance Officers Association state monitoring is important to determine if activities are complying with standards and ensure consistency, transparency, and accountability. Additionally, Montana Operations Manual (MOM) policy provides guidance to agencies relating to monitoring activities as part of their internal control systems. This includes “providing for the identification, capture, and exchange of information both with the agency and with external parties” and “monitoring the system over time to ensure that activities occur as intended.” A review of DOR documentation of TIF activities determined it does not have a process in place to identify or capture tax increment financing information. We also determined the DOR information about TIF districts that is available is incomplete, outdated, and inaccurate.

Available Tax Increment Financing Data Is Not Accurate

By not having a monitoring strategy in place, there is not accurate or timely documentation of the characteristics of active or expired TIF districts. Three DOR

central offices maintain some form of TIF data records, but these are incomplete, inaccurate, and not consistent over time or between the different offices. For example, PAD's list of TIF records alternates between listing TIF districts or listing the levy districts that make up TIF districts. It also does not include updated levy district codes; detailed information, such as boundary modification data; or historic TIF district information. PAD has established policy for each property record in a TIF district to be labeled with an exemption code in Orion, DOR's property assessment database, with details of the TIF district. However, 19 percent of TIF property was not labeled with the TIF exemption code in Orion, as of 2016.

TPR also maintains some TIF information in order to report information in their biennial report and to ensure they provide the correct amount of entitlement payments. Under §§15-1-121, MCA, and 15-1-123, MCA, some TIF districts are eligible to receive these entitlement payments to make up for past legislative changes in property tax rates. TPR compiles this data annually by requesting regional PAD staff fill out a form with TIF district information, such as base values, increment values, expiration dates, and outstanding bonds. However, interviews found regional staff do not know the answers to all of these questions and often leave portions of the form blank. TPR does not follow up on these incomplete forms, and TPR staff have stated they rarely use the information received in these forms. As a result, the following issues occur:

- ◆ Regional DOR staff are completing and submitting forms that are rarely used by TPR,
- ◆ Regional staff are reporting updates, such as bond extension information, to TPR, but TPR does not communicate district changes to the Helena PAD office, and
- ◆ TIF data reported by DOR in its biennial report is incomplete, outdated, and inaccurate.

A review of the TIF district records of PAD and TPR found they do not match, nor do they match documentation available from DOR's Legal Services, site visits, or survey responses. We compared the PAD list of TIF district records to both the TIF data published in the 2016 biennial report and survey results from TIF district managers. We identified discrepancies between these two records, including:

- ◆ 35 percent of recorded TIF districts or TIF levy districts on PAD's list have an expiration date that differed from what was reported by TPR in its 2016 biennial report or were left blank.
- ◆ 36 percent of PAD's records did not match the expected expiration date as reported by the TIF districts' managers in our survey.
- ◆ The base year for 17 TIF districts (31 percent) recorded between the two lists either differed from each other, were incorrect, or were left blank.
- ◆ Base values differed between the two lists for five TIF districts.

DOR's Legal Services also maintains records of TIF by retaining the original application packets, but they do not actually have a tracking system to manage this information or past decisions related to approval or denial of districts. The packets are a mix of both hard copy and electronic format, not well organized, are not consistent in the included documentation, and do not include all active districts. For example, we found documentation in incorrect folders, labeled incorrectly, or entirely missing. Both Legal Services and PAD are supposed to receive copies of documentation from local governments when they issue bonds to extend TIF district life. This ensures DOR knows what year the districts are supposed to sunset and be removed from the Orion system. However, local governments rarely alert Legal Services or PAD when they issue bonds, and not all regional PAD staff annually check in with local staff to determine if there have been any new bonds issued in the district.

A lack of TIF district monitoring, including basic data maintenance, means DOR is unable to determine whether or not districts are performing according to statutory requirements. This includes whether or not TIF districts are exceeding their 15 year maximum life span without bonds or 40 year maximum life span with bonds. DOR staff also stated they have not determined when statutory life span limits begin and end for TIF districts. Because DOR is the entity responsible for certifying district value, it is imperative it knows what period of time it should be certifying the district value for.

Lack of Accurate Data Hinders State Policy Decision Making

An additional concern relating to DOR district monitoring is the lack of available information regarding TIF districts to support informed policy decisions. The volume of legislative bills proposed and TIF related interim committee studies show that legislators are in need of TIF related information. In the 2017 Legislative Session alone, 13 bills were proposed involving tax increment financing, including 1 that initiated an interim study on TIF for the second interim in a row. Currently, state administrators and legislators do not have an accurate source of information to base policy decisions on. For example, without accurate information about the expected life span of active TIF districts, the legislature does not have a clear idea of future increment diversion. Additionally, they do not know what benefits, if any, the state is receiving from TIF activity across the state. As it stands, local governments are individually relied upon to provide anecdotal information to the legislature, often on a short time frame. This provides examples of isolated experiences with TIF, rather than a broad statewide view, and the state does not have data to corroborate locally provided information. Local governments experience extra costs to frequently travel to Helena during the legislative session and interim committee studies to provide information about tax increment financing because of the lack of statewide record keeping.

Data Maintenance Processes Not Established

A lack of a data maintenance process for TIF has occurred because DOR has not developed TIF-related policies and procedures. The various divisions and offices with TIF-related duties are not coordinated in their efforts to monitor the provision. The current record maintenance practices differ between regional offices, with some only maintaining documentation for three years, despite TIF districts remaining active for up to four decades. Due to the long life spans of TIF districts, this means important records are incomplete even while the district is still active.

Other states do require a state department to collect and maintain reports from TIF districts. For example, in North Dakota TIF districts must submit the total outstanding debt and balance of funds on hand for each district. Idaho also requires districts submit their urban renewal plans each year. In addition, Idaho is now in the process of creating a central registry of administrative and financial information of their urban renewal districts. Unlike Montana, Idaho state government does not collect any property tax and North Dakota state government only collects minimal property tax. Accordingly, Montana has more of a vested interest in monitoring TIF districts. Examples of basic information that DOR could maintain includes:

- ◆ The official date the district started,
- ◆ The base year,
- ◆ Historic certified base and increment values along with any corrections or changes to these values,
- ◆ Accurate and updated list of levy districts included in TIF districts,
- ◆ District plans, and
- ◆ District debt information such as the resolution approving the issuance of a bond.

They should also maintain this information well beyond the minimum three year public record requirement due to the long life span of the districts. Additional information regarding statewide methods of managing TIF districts, the use of TIF funds, and impacts experienced by local governments, could also be collected and maintained. How this data should be recorded, where, and by whom should be determined by DOR, along with periodic checks to ensure accuracy and completeness.

RECOMMENDATION #4

We recommend the Department of Revenue coordinate the collection, entry, and maintenance of tax increment financing district information by defining formal job duties and processes.

Department of Revenue Can Improve Communication of Expectations to External Stakeholders

Montana Operations Manual policy requires management to communicate quality information to external stakeholders to achieve department objectives. DOR has developed external communication methods for its other roles in administering taxation. For example, in regard to property tax assistance, its website includes information regarding how the program works, an explanation of the application process and required forms, a list of answers to frequently asked questions, and links to other useful information. There is no similar documentation to externally communicate DOR processes and expectations regarding TIF.

DOR staff admit the department does not publicly communicate expectations of local governments using and establishing TIF districts apart from administrative rules. For example, although ARM 42.19.1402 states the TIF application packet submission deadline for creating districts is February 1st, the department needs earlier notice to ensure property values are calculated on time for the district. DOR staff indicate local governments only learn of this requirement if they reach out to either the department or other local government staff who have previously created districts prior to submitting their packets.

DOR does not consistently communicate with local governments regarding TIF expectations, which has contributed to multiple lawsuits in the last 10 years. In each case, DOR expectations of local implementation of TIF were not well communicated to stakeholders. In a lawsuit between DOR and Anaconda-Deer Lodge County, the department objected to Anaconda's TIF remittances to a school district flexible spending account, which can be used for a number of different expenses, including capital construction, and is not part of the school budget limited by statutory caps on mill levies. DOR did not communicate their expectations for remitting TIF funds to school districts, nor did they hold other districts responsible for the same activity. Ultimately this case was dismissed because the judge determined that DOR does not have the authority to determine how school districts use their budget. Another lawsuit

with Fallon County can also be partially attributed to a lack of communication of expectations. Fallon County completed the process required to set up a TIF district but was ultimately rejected by DOR based on documentation inconsistencies, district size, and perceived attempt to capture, rather than generate, property tax growth. Prior to this case, DOR did not communicate what factors would be considered in district approval other than the documentation required by administrative rule. The Montana Supreme Court ruled that DOR may determine district qualification and create administrative rules, but DOR has not adopted related rules since. Consequently, expectations of DOR regarding local government TIF administration continues to be unclear, and communication with locals is still limited. The potential for future lawsuits remain due to this continued lack of understanding between local governments and DOR.

Stakeholders Are Uncertain of Tax Increment Financing Requirements

In Montana, TIF stakeholders include taxpayers, advisory boards, local government administrators, elected officials, and potential developers. While many of the individuals involved in the administration of TIF understand its basic principles, details regarding the implementation process, legal uses, and special circumstances surrounding the use of the provision are not well understood.

In both interviews and surveys, local government officials described general public confusion about how TIF works within their local communities. Some examples included taxpayers believing TIF was a separate additional tax, mistaking privately funded development with TIF projects, and believing allowable uses of TIF were illegal. Additionally, surveys and interviews show local administrators are also uncertain of the state's expectations for TIF. Some indicated they were uncertain who to contact at DOR regarding TIF questions. Others expressed concern they are not notified by DOR of changes to TIF statute. For example, one local manager said if there were changes to TIF it was their impression DOR would notify them of the changes, but there has been no communication from DOR despite multiple TIF laws passing the 2017 Legislature. Examples of other concerns local officials expressed included whether or not TIF funded infrastructure used to connect the district to existing infrastructure could later be connected to residents outside the district, and whether or not breweries constituted value-adding industry for development in TEDDs. These concerns are all based on state law relevant to all TIF districts, and thus a topic DOR could develop and communicate educational information to local governments.

Cohesive Communication Strategy of Tax Increment Financing Policy Should Be Developed

The current uncertainty surrounding the specifics of TIF implementation and state expectations is a result of DOR not developing complete policies and procedures regarding processes or expectations. Because of this lack of policy, DOR has not communicated expectations, has responded inconsistently and reactively to issues related to TIF implementation, and the department's involvement has varied over time on a case-by-case basis. There have also been regional differences in how DOR staff advise and assist local governments. This all culminates in overall confusion by stakeholders on state requirements and expectations for TIF.

However, DOR does provide communication tools for other programs it is responsible for. For example, the Liquor Control Division includes descriptions of different types of liquor permits, frequently asked questions, instructions on how to apply for permits, related contacts in the department, and other educational materials. DOR does not mention TIF on its website. In fact, the only agency website that describes TIF is a Department of Transportation page describing it as a potential incentive tool for infrastructure development, despite this agency not playing a role in the implementation or administration of TIF.

RECOMMENDATION #5

We recommend the Department of Revenue:

- A. *Further develop tax increment financing policies and procedures, and*
 - B. *Communicate these policies and procedures to stakeholders by providing, at a minimum:*
 - *A description of how TIF works,*
 - *A summary of legal requirements,*
 - *Answers to frequently asked questions,*
 - *Requirements to create or modify a TIF district, and*
 - *Points of contact for assistance.*
-

Chapter IV – TIF Statewide Impacts and Need for Statutory Clarification

Introduction

This chapter addresses both our last objective to determine the impacts of tax increment financing (TIF) in Montana, and overall need for the legislature to clarify TIF statute. Impacts were assessed first based on the extent to which the goals of urban renewal districts (URD) and targeted economic development districts (TEDD) are being met. This includes improvements such as property condition or successful addition of value-added industry in TIF districts. These impacts were evaluated based on a survey of TIF district managers, site visit interviews with local financial officers and TIF district managers, TIF-related document review, and an analysis of how TIF funds were spent. Next we conducted a statistical analysis to determine if TIF influences property value change over time compared to non-TIF property.

We found impacts vary between communities, and there are no state-level performance goals specific to TIF. No formal statewide analysis or assessment, apart from this audit, has been conducted of TIF impacts in Montana. TIF best practices created by the Government Financial Officers Association stress the importance of having objectives or strategic goals for TIF. They also state the necessity of periodic evaluation of TIF to determine if goals are being met and to determine its overall impact. Statute does not provide legislative guidance on goals specific to the use of the TIF provision apart from the goals of the development districts they are in. It also does not clearly define what responsibilities belong to state agencies or local government, how TIF should be evaluated, or what constitutes a “qualified” TIF district.

Statutory Goals Exist for Development Districts But Not for Tax Increment Financing

Neither state statute nor administrative rule have impact or performance requirements for TIF. Statute does, however, state the goals of development districts allowed under the Urban Renewal Law, such URDs and TEDDs. For URDs, §7-15-4203, MCA, sets forth a need for the redevelopment and rehabilitation of blighted areas. Section 7-15-4278, MCA, indicates TEDDs are meant to improve infrastructure to encourage the development and retention of value-adding industry, such as manufacturing or technology-based businesses.

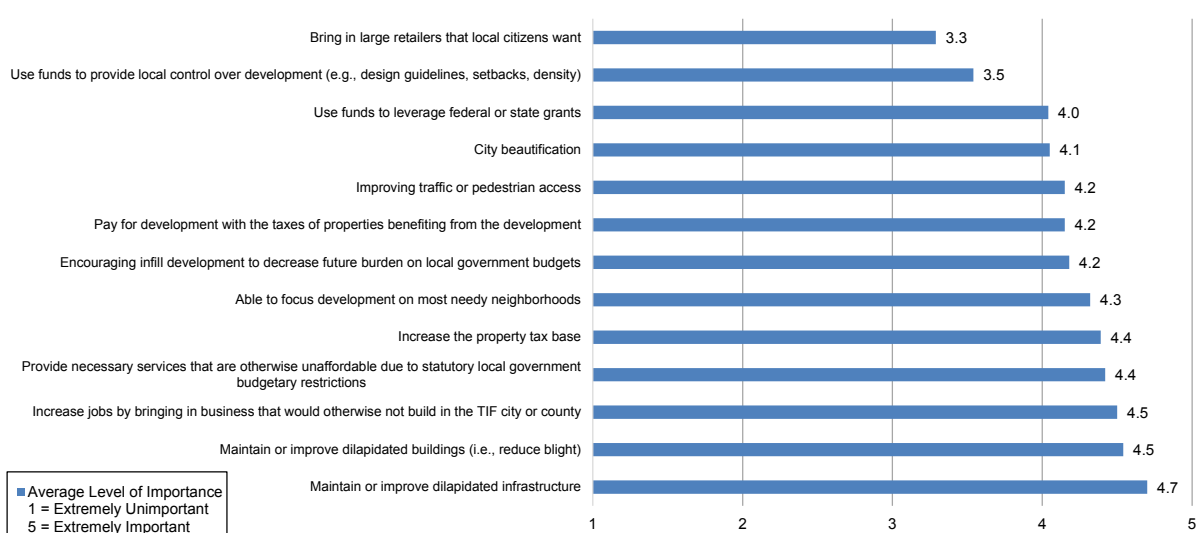
Reported Impacts of Tax Increment Financing by Local Government

As part of our work we interviewed TIF district managers and other local government staff in eight counties based on a judgmental sample to determine their perceptions regarding the impact of TIF. Overall, we found they thought TIF had a positive impact on their local government. Benefits discussed included encouraging infill development to lower the burden on municipalities to provide services across the town or city, decreasing blight, encouraging private development, or lowering local mill levies. They also stated development projects have a domino effect; when one vacant lot or local business is improved, often the nearby businesses or homes are inspired to improve their area as well. As one manager described it, once a few properties are improved, neighboring properties feel obligated to join in. This manager provided an example of one business receiving a small façade grant, and as a result, two neighboring businesses upgraded their exteriors without applying for a grant. Another manager stated TIF makes it easier to be more responsive when trying to attract developers and claimed alternative means of development assistance is both limited and delayed. This manager also said private developers want to make decisions quickly and often do not wait for more a traditional, slower government response, such as state grants.

Apart from the overall view that TIF has a positive local and statewide impact, some managers said they expected some districts had little to no impact on the community. In some cases, TIF districts do not accumulate an increment and thus never complete any work. However, local staff also stated the TIF districts that did not succeed were not harmful apart from the administrative effort that went in to implementing them, because unsuccessful districts typically never receive an increment or completed any projects.

Audit work related to TIF impacts included a survey to TIF managers and local government financial officers across the state. In the survey we asked them to rank the most important benefits of TIF in their community and invited them to share additional perceived impacts. Benefits were ranked between 1 and 5, with 1 representing extremely unimportant and 5 representing extremely important. Figure 9 (see page 45) displays these results.

Figure 9
Survey Respondents' Average Rank of Importance of TIF Benefits



Source: Compiled by the Legislative Audit Division from 2017 survey results.

As shown, these responses correspond with the statutory goals for URDs and TEDDs. However, increasing the property tax base was ranked fifth out of the 13 options. This suggests that while increasing the tax base is the underlying theory behind the provision, it is not the highest priority for the local governments. Instead, local governments see the most important benefit of creating TIF districts is to improve or maintain infrastructure in the area. This focus on public infrastructure is in line with the statutory goals for development districts.

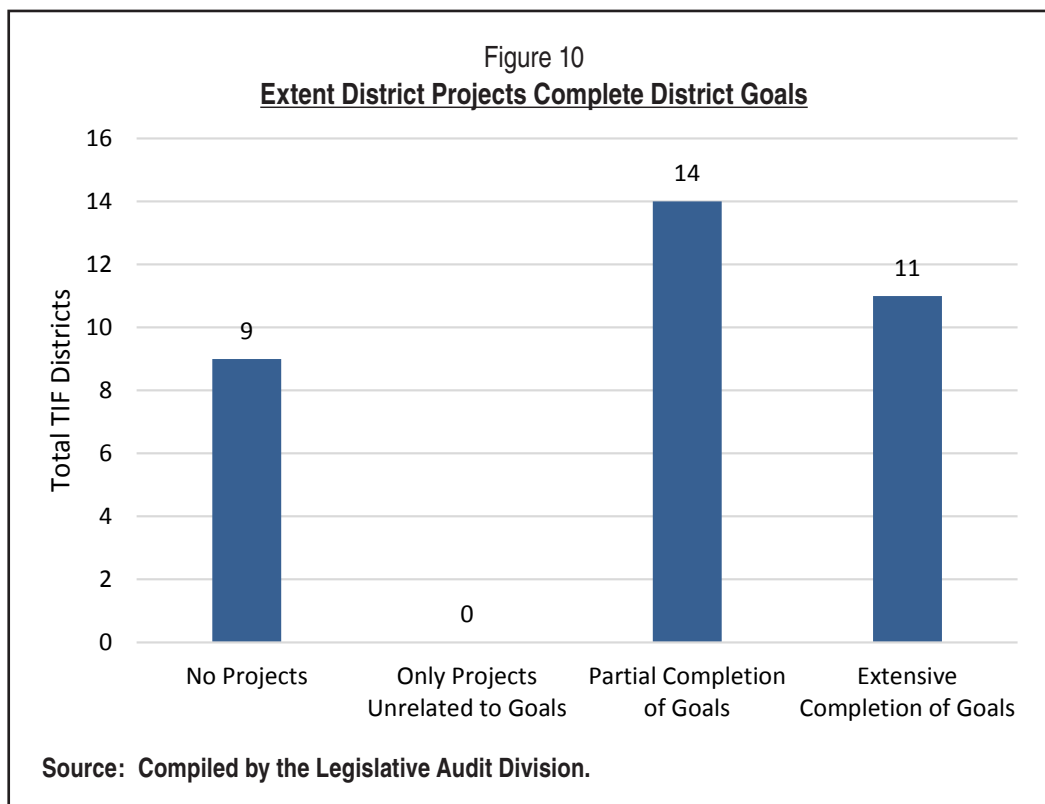
Survey respondents suggested positive impacts could be increased by maintaining the TIF program the way it is or increasing education about TIF. Suggestions included providing informational packets detailing TIF deadlines and required procedures, or ensuring uniform training for DOR staff. When asked for additional feedback about how to improve both state and local implementation of TIF, they noted either increasing intergovernmental communication between the different parties involved in implementation, or simplifying TIF requirements.

In regard to negative impacts of the TIF provision, a majority of survey respondents did not think there were any negative impacts when districts are created. Some suggested problems resulted because of a lack of public understanding about how TIF works. Others stated there could be negative impacts on other taxing jurisdictions that must wait until the district sunsets before being able to collect tax on the newly increased

property values. Overall, respondents thought there could be additional education or outreach to decrease perception of negative impacts.

Accomplishing District Needs and Goals With Tax Increment Financing

Audit work included interviews with local government staff and a review of available TIF district documentation, such as ordinances and plans, to determine the extent to which districts were addressing the original goals or justification for the district. For URDs, this considered whether the district had either addressed the indicators of blight used to advocate for creating the district in their original packet submitted to DOR's Legal Services, or if not available, then the goals within the urban renewal plan. For TEDDs and other districts, the overall intent was determined to be infrastructure improvement unless the original district packet detailed more specific goals. TIF district managers were interviewed about what projects had been completed in the district to date. When available, updated district project summaries were also reviewed. We then compared these projects to the goals found in the original district packets to determine what extent the original goals were accomplished. We then categorized each district as meeting one of the following four categories, depending on the extent goals were met, which are shown in Figure 10.



This figure shows TIF districts are attempting to address the reasons the district was justified for creation, with the exception of nine districts that do not have any tax increment or have not completed any projects. Twenty-five districts have partially or extensively addressed their original district goals to date. No districts appeared to use TIF increment to finance projects unrelated to original district goals or justification.

Impact of Tax Increment Financing on Property Value

Current TIF provisions of the Urban Renewal Law do not include any goals or performance guidelines for local governments. However, TIF is considered to be self-financing which means as projects are completed in the district, associated development is expected to provide an increase in property value and tax revenue to pay for those improvements. TIF is expected to increase property values above what they would have been had TIF not been used, justifying the segregation of the increment funds from the taxing jurisdictions that would have otherwise been allocated to the recipients. In order to assess whether or not TIF creates additional growth in property value, we conducted work to analyze its influence on the property value growth of parcels in TIF districts created between 2003 and 2014.

Overview of Analysis Methodology

A significant challenge in analyzing the effect of TIF is determining how to separate what portion of benefits experienced in the district occurred as a result of TIF, as opposed to benefits that would have been experienced regardless. To assess these benefits in property value growth, we conducted a statistical analysis in two stages. First, we identified a set of similar TIF and non-TIF parcels statewide, including land and associated improvements (buildings). Next, these parcels were compared to each other to determine if TIF had an effect on property value growth over time, after accounting for other conditions that could also affect property value growth. For the purpose of this analysis, property in TIF districts with base years between 2003 to 2014 were used to represent TIF property, as data for prior years was inconsistent and newer districts may not have had time to show the effects of TIF on property value growth. The TIF districts included in the analysis ranged from 11 to 3 years old. The analysis was set up conservatively, with a higher likelihood of understating the effect of TIF on property value.

For the first stage of the analysis, we selected a comparison pool of non-TIF parcels from each tax year to match the parcels added that year to a TIF district, resulting in a group of 7,911 TIF parcels matched with non-TIF parcels. These parcels were matched based on features determined likely to affect the decision to include a parcel in a TIF district, such as property size, market value per acre, property type, and local area

median income. Our work could not consider certain factors that could potentially influence property values because limited data was available. For example, property condition is a known influencer of property value growth but not considered due to limits on available data on the historical condition of property.

For the second stage of the analysis, we calculated the effect of TIF on property value growth while controlling for other factors that influence property value growth, such as population growth. In addition, the model also considered what influence demographic features had on the strength of TIF's effect on property value growth. The results of our analysis are outlined in the following sections.

Tax Increment Financing Has an Effect on Market Value, but Depends on Outside Factors

Our analysis found evidence TIF affects property value outside of normal inflation or demographic forces. However, the extent of this effect depends on other demographic characteristics of the community, such as area population growth, population size, and median income. For example, while property value growth appears to decrease for non-TIF parcels as population growth increases, this decrease is less drastic for TIF parcels. These are called crossover effects. With these crossover effects, the effect of TIF cannot be determined without considering these other characteristics.

As population grows, overall property value growth decreases for both TIF and non-TIF parcels. When population growth is negative or close to zero, property values for TIF parcels experience lower growth than non-TIF. As population growth rates increase, however, TIF parcel property value growth rates are less negatively affected and experience overall higher property value growth rates than non-TIF parcels.

Total area population influences the effect of TIF on property value growth. For example, in small towns and counties, TIF intervention on parcels results in little to no difference in the property value growth. However, in higher population areas, TIF results in higher property value growth than is experienced by non-TIF parcels.

Median income of an area also influences TIF effect on district property value. Our analysis found, as median income increases, the effect TIF has on property value begins to fall behind what occurs with parcels not part of a TIF district. Overall, in higher income areas, TIF may not be as effective at increasing property value.

Each of these interactions have crossover effects that may ultimately influence whether or not TIF increases property value above what would have occurred without the intervention. Our analysis included looking at how these interactions work together to

influence the effectiveness of TIF. Figure 11 shows an example of how these interactions have worked together to change the direction and strength of TIF influence on property value.

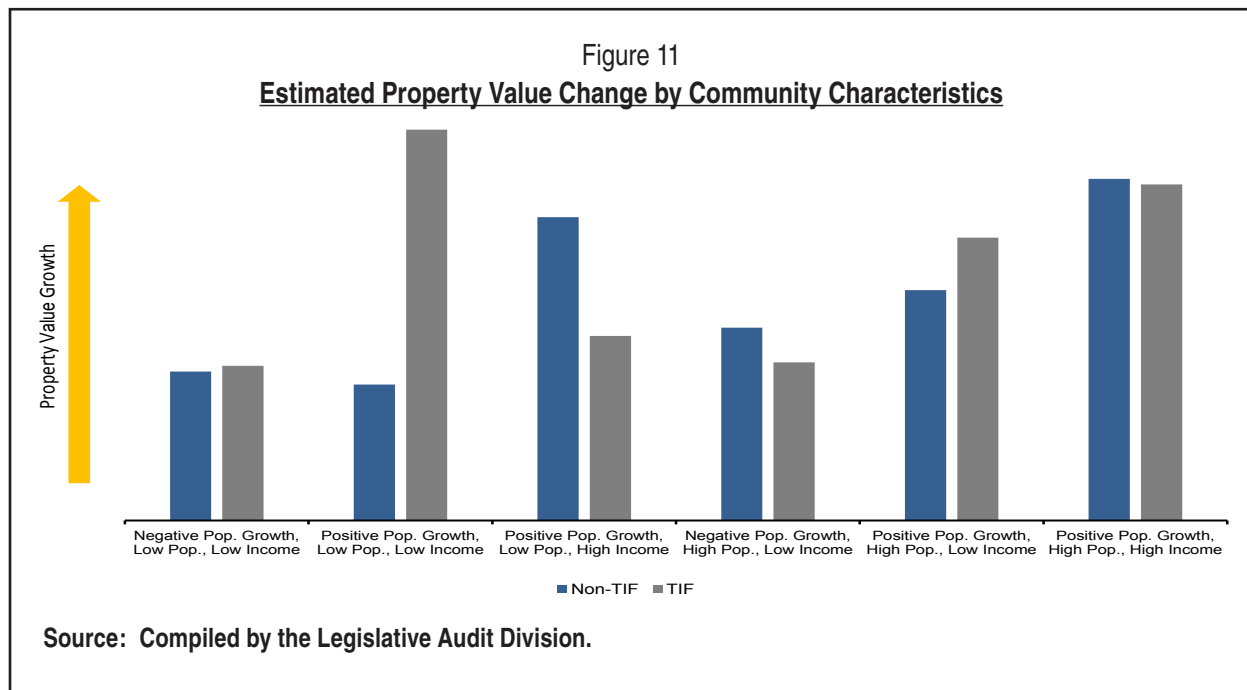


Figure 11 illustrates six different scenarios based on whether an area has negative or positive population growth, high or low overall population, and high or low median income. Both high and low overall population areas with negative population growth and high median income are not shown, due to these scenarios not being represented by TIF parcels used in the analysis. The remaining categories show the average property value change between TIF and non-TIF parcels when controlling for the factors put into the statistical model. As the figure shows, there are some cases in which the interactions lead to overall positive effects on property value growth for TIF parcels, such as in growing, but poorer communities of all sizes. However, there are also interactions that may lead to negative or neutral effects, such as for TIF parcels in small, growing communities with higher median incomes.

CONCLUSION

Demographics of different communities influence the success of tax increment financing for increasing property value growth. As a result, TIF can impact the growth of property value, but does not always increase property value above what the area would have experienced otherwise. Additionally, other factors outside of TIF, such as population growth, median income, and property type, can determine the extent and direction of changes in property value.

Statewide Analysis of Tax Increment Financing Performance Has Never Been Done

Outside of this audit, we identified a lack of a performance or impact analysis of TIF conducted by DOR or any other state entity. DOR does collect some TIF data and provides a basic summarization of incremental values held by TIF districts in their biennial report. However, DOR does not fulfill the Government Finance Officers Association's guidelines for monitoring performance of the provision. Therefore, when policy makers require performance and impact information regarding TIF, the information is generated through self-reporting by local governments during legislative hearings. Subsequently, legislators do not have complete statewide performance or impact information related to TIF when making policy decisions

Another consequence of the lack of statewide analysis is the lack of information available for local governments or other taxing jurisdictions. Therefore, local governments cannot determine if creating a TIF district is in their best interests long-term, or what the most effective ways are to administer districts. Potentially affected taxing jurisdictions also do not have information about the effect TIF districts may ultimately have on property value, thus hindering their best interests when creating TIF districts.

State-Level Tax Increment Financing Performance Measurements and Analysis Should Be Developed

Statute does not provide clear requirements for DOR to conduct performance analysis of TIF. DOR does have broad statutory authority in the administration of taxation, but the nature and extent of this role is not defined regarding TIF. DOR has not taken ownership over the administration of TIF, nor has it been prioritized for staff. In addition, statute does not include any guidance on desired performance measurements of TIF or methods of implementing such measurements. Consequently, DOR has not established performance measurements, collected required data, conducted any meaningful analysis, or shared their findings with various stakeholders. Instead, the state relies on local governments to self-report perceived impacts and performance of TIF districts to legislators and other stakeholders when questions arise.

State Laws Are Unclear and Lack Direction for State and Local Entities

Our work found even though TIF has been established for over 43 years, clear responsibilities have not been set in policy regarding its administration. Though DOR has broad authority for the general supervision over tax administration in the state, it is not clear what TIF responsibilities are included under that authority. As a result, DOR's role has been disjointed and inconsistent in TIF approval, certification, revenue

allocation, data compilation, and communication. In some areas of TIF administration, it is also not clear where DOR's role ends and local governments' begins.

There is a lack of guidance on what constitutes a "qualified" tax increment provision as required by §7-15-4285, MCA. Statute and previous court opinions indicate that DOR does have the ability to deny districts that are not qualified based on administrative rule. However, neither statute nor administrative rule define any criteria, apart from process requirements, that should be considered in determining qualification. Presently, DOR staff state they only decide qualification based on the submission of required documentation to the department as defined in ARM. Other potentially inappropriate district characteristics, such as size or intent to capture rather than create increment, are not defined by rule or statute. As a result, the state risks approving districts that followed the appropriate public process to be created but are not reasonable attempts at meeting legislative intent for TIF. If DOR were to deny a district based on size or other criteria, the local governments would not know of these requirements. Without knowledge of what additional requirements may be considered when DOR is determining if a district is qualified, such as a TIF district's size, local governments are at risk of completing the burdensome TIF creation process only to find it was not qualified according to unknown department requirements.

Additionally, there is a lack of clear state goals or performance measurements for TIF, and no state entity is currently evaluating the provision. Our work found TIF has funded blight remediation and infrastructure development projects and can influence property value growth, but benefits are not uniform and may be influenced by external environmental factors. Because of the provision's complexity and the segregation of state mills to fund TIF projects, it is in the state's interest to evaluate their use to ensure there is an overall positive state benefit.

To better oversee the TIF provision, the legislature should clarify TIF responsibilities, expectations, and processes at both the state and local level. In particular, the legislature should define what factors should be considered in district qualification for DOR approval. Additional examples of some potential areas of clarification include:

- ◆ Defining state agencies', county treasurers', and local governments' responsibilities in administering and monitoring TIF,
- ◆ Determining what education and support should be provided for local governments and citizens regarding TIF,
- ◆ Further defining TIF reporting requirements for local governments,
- ◆ Establish formal reporting requirements for state collected TIF information,
- ◆ Identifying goals for TIF, and

- ♦ Directing what entity should evaluate whether or not TIF meets identified goals.
-

RECOMMENDATION #6

We recommend the Montana Legislature:

- A. *Define what criteria the Department of Revenue should review to approve qualified tax increment provisions as described in §7-15-4285, MCA, and*
 - B. *Clarify tax increment financing laws, including statutory goals, state and local administration, monitoring, and how TIF should be evaluated.*
-

DEPARTMENT OF REVENUE

DEPARTMENT RESPONSE



Mike Kadas
Director

Montana Department of Revenue



Steve Bullock
Governor

February 9, 2018

Angus Maciver, Legislative Auditor
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RECEIVED
FEB 12 2018
LEGISLATIVE AUDIT DIV.

Dear Mr. Maciver:

Thank you for the opportunity to respond to the Tax Increment Financing Administration and Impact Audit Report recently completed. As a preliminary matter, and as discussed during the recent audit review meeting, the department has limited scope of authority over the tax increment financing (TIF) process required by local governments. The department is constrained by statutory and common law from requiring local governments to comply with their requirements to establish and administer TIFs. As the department indicated in the audit review meeting, these limitations are borne out by the Third Judicial District Court's determination in *Anaconda-Deer Lodge County v. Montana Department of Revenue* that the department did not have standing to act on behalf of local taxpayers to challenge the methods of spending tax dollars related to TIFs.

With this understanding, as to the legal limitations on the department's authority, our response to the recommendations is as follows:

Recommendation #1:

We recommend the Department of Revenue:

- A. Update tax increment financing administrative rules to require local governments submit documentation that demonstrates they met statutory requirements when creating TIF districts, and*

Partially Concur. The department can only require local governments to submit documentation to the extent the statute allows. The department will work to improve the current rules so they are more clear and concise.

- B. Develop and implement policies and procedures to accurately communicate deadline requirements to local governments.*

Partially Concur. The department routinely communicates with local governments about our policies and procedures. We will work to include TIF district personnel in communications with local governments. As part of this process, we will develop a timeline with key dates for current and proposed TIF districts. This will be placed in the TIF section we are developing on our website.

Recommendation #2:

We recommend the Department of Revenue improve certification of tax increment financing taxable values by:

- A. Developing and implementing a process to verify certified base and increment values for TIF districts before sending them to local taxing jurisdictions, and*

Partially Concur. The department has detailed procedures and processes to verify certified values of all taxing jurisdictions. We will work to improve the process of certifying values for not just the 55 TIF districts, but the thousands of other taxing jurisdictions.

- B. Defining formal lines of communication between local governments and the department for questions relating to TIF district values.*

Concur. The department agrees that communications can be improved. The department will review the best method for communicating with local governments. As well, a list of key contacts for each county will be included as part of the TIF section we are adding to the department's website.

Recommendation #3:

We recommend the Department of Revenue guide and support county treasurers by developing an alternative method to calculate tax increment revenue according to the district-wide increment and base values of tax increment financing districts.

Concur. The department will continue to provide training and work with county treasurers to ensure the calculation of tax increment revenue is correct. We will put the formula on our website and encourage local governments to require their software vendors accurately calculate the distribution of property tax revenue to TIF districts.

The department believes the distribution of revenue is based on the sum of the total property tax collected for each taxing jurisdiction in the TIF district. The total revenue is then allocated based on the ratio of taxable value of the base value divided by the total taxable value of the TIF district and the taxable value of the increment divided by the total taxable value of the TIF district. These percentages are applied to the total property tax collected in the district less the 6-mill revenue.

Recommendation #4:

We recommend the Department of Revenue coordinate the collection, entry, and maintenance of tax increment financing district information by defining formal job duties and processes.

Concur. The department currently has well-defined procedures and processes, but will continue to fine tune the processes and clarify staff responsibilities.

Recommendation #5:

We recommend the Department of Revenue:

A. Further develop tax increment financing policies and procedures, and

Concur. The department currently has well-defined procedures and processes, but will continue to fine tune the processes and clarify staff responsibilities.

B. Communicate these policies and procedures to stakeholders by providing, at a minimum:

- A description of how TIF works,*
- A summary of legal requirements,*
- Answers to frequently asked questions,*
- Requirements to create or modify a TIF district, and*
- Point of contact for assistance.*

Concur. The department will work to improve both our internal and external communications. The department believes the TIF section being developed on our website will address this recommendation.

Recommendation #6:

We recommend the Montana Legislature:

A. Define what criteria the Department of Revenue should review to approve qualified tax increment provisions as described in §7-15-4285, MCA, and


Concur. The department agrees that the Legislature needs to provide stronger and clearer criteria for the approval of a TIF district.

B. Clarify tax increment financing laws, including statutory goals, state and local administration, monitoring, and how TIF should be evaluated.

Partially Concur. Although this is a recommendation for the Legislature, the department strongly agrees that the Legislature provide explicit authority contained in

this recommendation and the resources necessary to implement any new statutory requirements.

Sincerely,


for Mike Kadas, Director